TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, ~~1940~~ 1941

No. ~~782~~ 29

AMERICAN SURETY COMPANY OF NEW YORK,
PETITIONER,

vs.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, AND L. M. REED, AS RECEIVER OF THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 21, 1941.

CERTIORARI GRANTED MARCH 31, 1941.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN DISTRICT COURT OF THE UNITED STATES
EASTERN DISTRICT OF PENNSYLVANIA

No. 514 Civil Action

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,
Plaintiff

vs.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. Reed, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, Respondent

DOCKET ENTRIES

Sept. 13, 1939, Complaint filed.
Sept. 13, 1939, Summons exit to counsel for acceptance of service.
Sept. 18, 1939, Summons returned "service accepted" and with directions to enter appearance of H. P. McFadden, Esq., for defendants filed.
Oct. 5, 1939, Motion to dismiss and notice of motion filed.
Nov. 8, 1939, Stipulation of counsel as to certain facts filed.
Nov. 8, 1939, Argument sur motion to dismiss action.
Mar. 6, 1940, Opinion, Kirkpatrick, Judge, granting judgment for plaintiff on the pleadings filed.
Mar. 18, 1940, Stipulation of counsel and Order of Court substituting defendant filed.
May 20, 1940, Stipulation of counsel and Order of Court substituting party defendant filed.
[fol. 2] May 20, 1940, Stipulation of counsel as to entry of judgment filed.
May 20, 1940, Judgment in favor of plaintiff filed.
May 21, 1940, Noted and notice mailed.
June 18, 1940, Notice of defendant's appeal filed.
June 19, 1940, Copy to R. Slattery.

June 18, 1940, Copy of Clerk's notice to U. S. Circuit Court of Appeals filed.

July 25, 1940, Stipulation of counsel as to record on appeal filed.

July 31, 1940, Order of Court extending time for filing record on appeal filed. 8/1/40 Noted & notice mailed.

[fol. 3] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Complaint—Filed September 13, 1939

To the Honorable the Judges of the Said Court:

Plaintiff complains of the defendants, and for cause of action alleges:

1. That the plaintiff is a corporation organized and existing under and by virtue of the laws of the State of New York, and is a citizen and resident of the State of New York, and is and at the times hereinafter mentioned has been duly authorized by its charter to engage in the business of suretyship and qualified to engage in such business under the laws of the Commonwealth of Pennsylvania, and is and at said times has been engaged in said business in the Commonwealth of Pennsylvania.

2. That The Bethlehem National Bank of Bethlehem, Pennsylvania, is a national banking association and a corporation organized and existing under the laws of the United States, and in particular under the Act of Congress known as the "National Banking Act" and has its place of business in the City of Bethlehem, Pennsylvania, and is a citizen and resident of said Commonwealth of Pennsylvania.

3. That the defendant, Benjamin Nieman, is a citizen and resident of the State of Pennsylvania. That deeming such action necessary in order to conserve the assets of said The Bethlehem National Bank of Bethlehem, Pennsylvania, for the benefit of depositors and other creditors thereof, the Comptroller of the Currency of the United States of America did, on the 15th day of March, 1933, appoint one Charles Mohan conservator of said Bank. That thereafter

the said Charles Mohan duly qualified as such conservator, [fol. 4] and did under the direction of said Comptroller of the Currency take possession of the books, records and assets of said Bank, and did act as such conservator as provided by law, until August 3, 1933, when he resigned and was succeeded by one Fred T. Beckel who qualified and served as conservator of said Bank, by order and appointment of said Comptroller of the Currency, until March 26, 1934. That on or about March 26, 1934 the said Comptroller of the Currency made and issued his order appointing one Harry Margolis as receiver of said Bank, and that said Harry Margolis qualified and served as such receiver until April 20, 1937. That on or about April 20, 1937 the said Comptroller of the Currency made and issued his order appointing the defendant, Benjamin Nieman, as receiver of said Bank to succeed said Harry Margolis. That thereupon the said defendant, Benjamin Nieman, qualified as such receiver, took possession of the books, records and assets of every description of said Bank, and as such receiver is charged with the duty of liquidating, and is proceeding to liquidate, the business and assets of said Bank.

4. That the amount in controversy in this suit, exclusive of interest and costs, exceeds the sum or value of Three Thousand Dollars ($3,000.00).

5. That on the 10th day of December, 1928, in order to secure the repayment of moneys deposited or to be deposited in said The Bethlehem National Bank of Bethlehem, Pennsylvania, by the Commonwealth of Pennsylvania, the plaintiff made, executed and delivered its depository bond in the sum of One Hundred Twenty Five Thousand Dollars ($125,0000.00), in behalf of said The Bethlehem National Bank of Bethlehem, Pennsylvania, and in favor of the Commonwealth of Pennsylvania.

6. That on March 15, 1933, on which date the aforesaid Charles Mohan was appointed conservator of said Bank, there was on deposit therein to the credit of the Commonwealth of Pennsylvania or its duly qualified State Treasurer the sum of One Hundred Thirty-Five Thousand Dollars ($135,000.00), the payment of which deposit was secured by the depository bond executed and delivered as aforesaid by the plaintiff and also by the pledge by said Bank to the Commonwealth of Pennsylvania of Twelve

Thousand Dollars ($12,000.00), par value of bonds of the [fol. 5] United States of America.

7. That thereafter, on October 16, 1933, the plaintiff paid to the Commonwealth of Pennsylvania upon its demand the sum of Fifty Thousand Dollars ($50,000,00) on account of plaintiff's liability under its said depository bond.

8. That thereafter, on March 27, 1934, a distribution of forty per cent (40%) of the amount of all deposits was made by Harry Margolis, then receiver of said Bank as aforesaid, and the amount of such distribution, to wit, the sum of Fifty-Four Thousand Dollars ($54,000.00) was thereby received by the Commonwealth of Pennsylvania, which had theretofore filed with said Bank duly executed proof of claim for One Hundred Thirty-Five Thousand Dollars ($135,000.00) as the aforesaid sum of its deposit.

9. That thereafter, on or about April 23, 1934, the aforesaid bonds of the United States of America were sold and the proceeds amounting to Twelve Thousand Four Hundred Eleven Dollars and Forty-four Cents ($12,411.44) were received by the Commonwealth of Pennsylvania.

10. That thereafter, on April 27, 1934, the plaintiff paid to the Commonwealth of Pennsylvania the sum of Twenty Thousand Seven Hundred Thirty-eight Dollars and Ninety Cents ($20,738.90) as further payment on account of its liability under its said depository bond, and on April 28, 1934 plaintiff paid to the said Commonwealth the sum of One Thousand Five Hundred Thirteen Dollars and Eighty-seven Cents ($1,513.87) in settlement of its said liability, which payment, together with the amounts previously received through the distribution by the receiver and through the sale of collateral and the prior payment by the plaintiff, fully satisfied and discharged the claim of said Commonwealth of Pennsylvania on account of the balance standing to its credit on deposit in said The Bethlehem National Bank of Bethlehem, Pennsylvania, on March 15, 1933 and amounting to the sum of One Hundred Thirty-five Thousand Dollars ($135,000.00) as aforesaid.

11. That thereafter, on May 10, 1934, the said Commonwealth of Pennsylvania, by its duly qualified State Treasurer, for value received as aforesaid, did duly assign, trans- [fol. 6] fer and set over to plaintiff its said claim against

said The Bethlehem National Bank of Bethlehem, Pennsylvania, and ever since said date plaintiff has been and now is the owner and holder of said claim.

12. That thereafter, on December 12, 1935, said Harry Margolis, as receiver of said Bank, made a second distribution to creditors thereof of twenty per cent (20%) of the amount of their deposits standing to their credit on the 4th day of March, 1933, and the defendant, Benjamin Nieman, on July 16, 1938, made a third distribution to said creditors of ten per cent (10%) of said deposits, but said Harry Margolis, as to said twenty per cent distribution, and the defendant, as to both said twenty per cent distribution and said ten per cent distribution, have failed and refused to make any distribution or to pay any dividend to plaintiff upon the basis of the deposit standing to the credit of the Commonwealth of Pennsylvania on March 15, 1933, and amounting to the sum of One Hundred Thirty-five Thousand Dollars ($135,000.00) which said claim has heretofore been assigned to and is now held by the plaintiff as aforesaid.

13. That instead of making distribution or paying the second said dividend to plaintiff, at the twenty per cent (20%) rate payable to depositors, upon the basis of the said Commonwealth of Pennsylvania deposit amount existing on March 15, 1933, said Harry Margolis, the first receiver, offered to pay plaintiff said dividend on the basis of a principal sum of One Hundred Twenty-two Thousand Five Hundred Eighty-eight Dollars and Fifty-six Cents ($122,588.56) only, and deducted from said dividend amount an alleged overpayment on the aforesaid first dividend paid to the Commonwealth of Pennsylvania; which offer, with the condition attached in and upon the official dividend receipt that it be accepted as a dividend on the full amount of the plaintiff's claim, said Harry Margolis first made on December 23, 1935 to plaintiff at the net amount of $19,553.13 upon a calculation given by him to plaintiff by letter of which a true and correct copy is hereto attached, marked Exhibit "A".

That subsequently, on July 11, 1936, said Harry Margolis, as receiver, reduced his aforesaid offer to pay said 20% [fol. 7] dividend to plaintiff to a dividend sum of $13,717.71, upon a calculation given by him to plaintiff by letter of which a true and correct copy is hereto attached, marked Exhibit "B".

14. That instead of making distribution or paying the said third dividend to plaintiff, at the ten per cent (10%) rate payable to depositors, on the basis of the deposits standing to the credit of the Commonwealth of Pennsylvania on March 15, 1933, the defendant, Benjamin Nieman, without then or previously withdrawing the aforementioned conditions of receipt imposed upon the plaintiff's acceptance of the payments offered by said Harry Margolis as receiver, offered on August 30, 1939 to pay to plaintiff said 10% dividend on the basis of a principal sum of $122,588.56 only. That from July 11, 1936 to August 30, 1939 no offer to pay any dividend on a basis of any sum greater than the sum of $68,588.56 mentioned in the aforesaid letter of July 11, 1936 hereto attached as Exhibit "B", was made by either said Harry Margolis or the defendant, Benjamin Nieman.

15. That the plaintiff is entitled to the allowance of its claim for and upon the basis of the full amount of the deposit standing to the credit of the Commonwealth of Pennsylvania on the 15th day of March, 1933, to wit, the sum of One Hundred Thirty-five Thousand Dollars ($135,000.00) and is entitled to receive dividends computed thereon until such dividends shall equal the amount remaining unpaid on said claim after crediting thereon the sum of $54,000 received by said Commonwealth of Pennsylvania as a distribution by the first receiver of the defendant bank (as set forth in Paragraph 3 hereof) and the further sum of $12,411.44 received by said Commonwealth of Pennsylvania through the sale of the collateral pledged to it (as set forth in Paragraphs 6 and 9 hereof).

16. That the plaintiff is entitled to the allowance of legal interest upon the amount of such dividends as have been heretofore approved and paid to other depositors of defendant bank, and withheld from the plaintiff as aforesaid, from the date of the distributions herein averred to the date of payment thereof by the defendant, Benjamin Nieman, to the plaintiff.

Wherefore, plaintiff prays judgment as follows:

1. That plaintiff's claim herein in the sum of One Hundred [fol. 8] Thirty-five Thousand Dollars ($135,000.00) be allowed against the defendant, Benjamin Nieman, as receiver of The Bethlehem National Bank of Bethlehem, Pennsyl-

vania, and that the Court enter judgment herein that the plaintiff is entitled to participate with the other creditors of the defendant bank upon its said debt of $135,000 ratably in all distribution of dividends, including all dividends yet to be paid by defendant receiver as well as those already paid by the defendant receiver and his predecessor in office, until such dividends, together with the amounts heretofore received by the Commonwealth of Pennsylvania as hereinbefore set forth shall equal the sum of $135,000.

2. That the defendant receiver be directed to pay to the plaintiff a dividend of twenty per cent (20%) and a dividend of ten per cent (10%) upon the basis of $135,000, as the same basis upon which other creditors in the list of common creditors were paid such dividends, and to pay to plaintiff ratably with other creditors upon the said sum of $135,000.00 all future dividends to be declared and made payable to said common creditors.

3. That defendant receiver be directed to pay to the plaintiff interest at the rate of six per cent (6%) per annum on the sum of $27,000, as said 20% dividend upon $135,000, from December 12, 1935 until said dividend is paid to plaintiff, and to pay to plaintiff interest at the rate of six per cent (6%) per annum on the sum of $13,500, as said 10% dividend upon $135,000 from July 16, 1938 until said dividend is paid to plaintiff.

4. That defendant receiver be required to pay the reasonable attorney's fees to be fixed by the Court and to be allowed to the plaintiff.

5. For plaintiff's costs herein incurred.

(S) Rutledge Slattery, (S) Frank P. Slattery, Attorneys for Plaintiff.

[fol. 9] EXHIBIT "A" TO COMPLAINT

THE BETHLEHEM NATIONAL BANK
Harry Margolis, Receiver
Third and Adams Streets
Bethlehem, Pa.
December 23, 1935

American Surety Company of New York,
Land Title Building,
Broad and Chestnut Streets,
Philadelphia, Pennsylvania.

GENTLEMEN:

We desire to advise you that a second dividend, amounting to twenty per cent (20%), has been approved by the Comptroller of the Currency, and we are enclosing herewith a receipt for your dividend check in the amount of $19,553.13, as detailed in the following schedule:

Original deposit of the Commonwealth of Pennsylvania and subsequently assigned to the American Surety Co. on May 10, 1934	$135,000.00
Deduct: Proceeds from sale of 12M United States Treasury Bonds, 3 1/8%, 1946-1949 assigned to the Commonwealth of Pennsylvania as collateral for these deposits	12,411.44
Net Deposit	$122,588.56
First dividend of 40% actually paid (40%) of $135,000.00)	54,000.00
Correct amount of First Dividend amounting to 40% (40% of $122,588.56)	49,035.42
Net Excess Payment	$4,964.58
Second Dividend of 20% (20% of $122,588.56)	$24,517.71
Deduct: Excess payment in connection with distribution of First Dividend	4,964.58
Net Amount of Second Dividend	$19,553.13

Please sign this receipt, insert your address, and return promptly to this institution and the check will be forwarded to you by return mail.

Referring to your claim for interest indicated in your letter dated November 14th, the matter will be submitted to

the Comptroller of the Currency, and you will be notified as to his decision at a later date.

Yours very truly,

(sgd.) Harry Margolis, Receiver.

[fol. 10] EXHIBIT "B" TO COMPLAINT

THE BETHLEHEM NATIONAL BANK
Harry Margolis, Receiver
Third and Adams Streets
Bethlehem, Pa.

July 11, 1936

Mr. V. W. Nash, Manager,
American Surety Company,
100 Broadway,
New York, New York.

DEAR SIR:

Reference is made to your letters dated June 9th, May 19th, April 29th, March 7th, February 27th, 1936, and December 28, 1935, with respect to the second dividend due the American Surety Company, subrogee of the deposit claim due the Commonwealth of Pennsylvania by The Bethlehem National Bank.

We desire to advise you that the office of the Comptroller of the Currency, Washington, D. C., has authorized us to release a second dividend check amounting to $13,717.71, which represents twenty per cent (20%), of the principal balance you paid the Commonwealth of Pennsylvania in the amount of $68,588.56 as detailed in the following analysis:

Original Amount of Deposit		$135,000.00
Deduct: First dividend of Forty per cent, (40%), paid to Commonwealth of Pennsylvania	$54,000.00	
Proceeds from sale of collateral	12,411.44	66,411.44
Net Balance		$68,588.56
Twenty per cent dividend on Net Balance due the American Surety Company, subrogee,		$13,717.71

Your attention is directed to the decision of the United States Circuit Court of Appeals in the case of Ward v. First National Bank of Caruthersville, 76 F. (2) 256, and it is our opinion that under that decision the American Surety Company is entitled to future dividends on the sum of $68,588.56 only and should not receive dividends on the entire balance of the Commonwealth of Pennsylvania deposit as of the closing date.

Very truly yours,

(sgd.) Harry Margolis, Receiver.

[fol. 11] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Motion to Dismiss—Filed October 5, 1939

The defendants move your Honorable Court as follows:

1. To dismiss the action because the complaint fails to state a claim against defendants upon which relief can be granted.

(S.) H. P. McFadden, Attorney for Defendants, 112 East Third Street, Bethlehem, Pa.

[fol. 12] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Notice of Motion—Filed October 5, 1939

To Rutledge Slattery, Esq., and Frank P. Slattery, Esq., 2020 Packard Building, Philadelphia, Pa., Attorneys for Plaintiff.

Please take notice that the undersigned will bring the above motion on for hearing before this Court at Room —, New Customs House, Second and Chestnut Streets, Philadephia, Pennsylvania, on the 16th day of October, 1939, at

ten o'clock in the forenoon of that day or as soon thereafter as counsel can be heard.

(S.) H. P. McFadden, Attorney for Defendants, 112 East Third Street, Bethlehem, Pa.

[fol. 13] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Stipulation as to Certain Facts—Filed November 8, 1939

It is stipulated by and between the parties hereto that the allegations contained in Paragraphs 1 to 10, inclusive, of the Bill of Complaint are admitted.

Paragraph 11. It is admitted that the said Commonwealth of Pennsylvania by its duly qualified State Treasurer executed and delivered to the plaintiff an instrument purported to be an assignment of the claim of the Commonwealth to the plaintiff, a true and correct copy of which is hereunto attached marked Exhibit A.

Paragraph 12. The facts stated in Paragraph 12 are admitted; the defendant contends however that the purported assignment of a claim for $135,000 was without legal effect and that the plaintiff is entitled to be reimbursed only on a basis of the amount paid by the plaintiff to the Commonwealth.

The allegations contained in Paragraphs 13 and 14 are admitted.

Paragraph 15. It is admitted that the plaintiff claims as alleged in this paragraph, but the defendant contends that the plaintiff is only entitled to be reimbursed on the basis of the amount paid by the plaintiff to the Commonwealth.

Paragraph 16. It is admitted that the plaintiff claims as alleged in this paragraph, but the defendant contends that the plaintiff is not entitled to the recovery therein requested.

It is further stipulated that the above case is to be submitted to the Court on the basis of the complaint and this [fol. 14]stipulation for determination as on a rule for judgment on the pleadings.

(S.)Rutledge Slattery, (S.) Frank P. Slattery, Attorneys for Plaintiff. (S.) H. P. McFadden, Attorney for Defendant.

[fol. 15] EXHIBIT "A" TO STIPULATION AS TO CERTAIN FACTS

The American Surety Company of New York, New York, having become surety for The Bethlehem National Bank, Bethlehem, Pennsylvania, on its bond dated December 10, 1928, in the sum of One Hundred Twenty-five Thousand ($125,000) Dollars, unto the Commonwealth of Pennsylvania, securing deposits of state funds in said bank, and The Bethlehem National Bank, Bethlehem, Pennsylvania, having also posted collateral in the form of U. S. Treasury 3⅛% bonds, par value of $12,000, unto the Commonwealth of Pennsylvania; and the said The Bethlehem National Bank, Bethlehem, Pennsylvania, having been placed in the hands of a Conservator on or about March 7, 1933, and the Treasurer of the Commonwealth of Pennsylvania having on deposit at the time said bank was placed in the hands of a Conservator the sum of One Hundred Thirty-five Thousand ($135,000) Dollars and accrued interest amounting to One Thousand Five Hundred Thirty-nine and 95/100 ($1539.95) Dollars, secured by bonds as aforesaid; and the said Treasurer of the Commonwealth of Pennsylvania having made and filed due claim and demand with the Conservator in charge of said The Bethlehem National Bank, Bethlehem, Pennsylvania, for the amount due on said deposit with accrued interest, making a total of One Hundred Thirty-six Thousand Five Hundred Thirty-nine and 95/100 ($136,539.95) Dollars, and the said Treasurer of the Commonwealth of Pennsylvania having also made due claim and demand upon said American Surety Company of New York, New York, for payment of its liability for said deposit, pursuant to bonds as aforesaid:

Now, therefore, this is to acknowledge receipt from said American Surety Company of New York, New York, of the sum of Seventy Two Thousand Two Hundred Fifty-two and 77/100 ($72,252.77) dollars in full discharge of its liability under said bonds, (On March 27, 1934 the sum of Fifty-four Thousand ($54,000) Dollars of the aforementioned deposit [fol. 16] having been paid to the Commonwealth of Pennsylvania from The Bethlehem National Bank, Bethlehem, Pennsylvania, and on April 23, 1934 the above mentioned $12,000 par value of U. S. Government securities held as collateral to secure state deposits having been sold and the proceeds in the amount of $12,411.44 were credited to the

account of The Bethlehem National Bank, Bethlehem, Pennsylvania), and to subrogate said American Surety Company of New York, New York, to all the rights and remedies of the undersigned in the premises to the extent of Seventy Thousand Seven Hundred Thirty-eight and 90/100 ($70,738.90) Dollars, said last mentioned amount representing Sixty-eight Thousand Five Hundred Eighty-eight and 56/100 ($68,588.56) Dollars, the balance of state deposit, and Two Thousand One Hundred Fifty and 34/100 ($2,150.34) being the interest liability from January 1, 1933 to April 28, 1934, inclusive, of said The Bethlehem National Bank, Bethlehem, Pennsylvania, to the Commonwealth of Pennsylvania, for which said American Surety Company of New York, New York, was liable as surety; and the undersigned hereby assigns, transfers and sets over unto the American Surety Company of New York, New York, all his right, title and interest in and to his said claim against said The Bethlehem National Bank, Bethlehem, Pennsylvania.

Dated May 10, 1934.

Charles A. Waters, Treasurer of the Commonwealth of Pennsylvania

STATE OF PENNSYLVANIA,
County of Dauphin, ss:

On this 10 day of May, 1934, before me, personally appeared Charles A. Waters, who, being by me duly sworn, did depose and say that he is Treasurer of the Commonwealth of Pennsylvania and that he, as such, has authority to execute the foregoing instrument, and he duly acknowl- [fol. 17] edged to me that he executed the same for the purposes therein mentioned.

William J. Kennard, Notary Public. My Commission Expires March 17, 1937. DS.

[fol. 18] I hereby certify the above to be a true and correct copy of the assignment as furnished the American Surety Company of New York, New York.

(Sgd.) J. S. Byerly, for Charles A. Waters, State Treasurer.

Received and filed June 8, 1934.

The Bethlehem National Bank, By —— ——, (Sgd.) Harry Margolis, Receiver.

[fol. 19] IN DISTRICT COURT OF THE UNITED STATES, EASTERN DISTRICT OF PENNSYLVANIA

[Title omitted]

OPINION SUR MOTION FOR JUDGMENT ON THE PLEADINGS—Filed March 6, 1940

Before Kirkpatrick, J.

This is a suit by the surety upon a bond, given by the now insolvent Bethlehem National Bank as security for the deposit of the Commonwealth of Pennsylvania, to recover dividends declared by the receiver. The right of the plaintiff to dividends is not disputed, but the amount is. The point at issue is the basis for the dividend, that is, the amount of the claim upon which it should be calculated and paid.

The case came before the Court upon a motion to dismiss but, inasmuch as it appeared at the argument that no facts were in dispute, the parties filed a stipulation (which for all practical purposes amounts to an amendment of the complaint and an answer admitting all fact allegations) and agreed that the Court should dispose of the case as on a rule for Judgment on the pleadings.

When the Bank closed, the Commonwealth's deposit amounted to $135,000. It was secured by the Bank's bond for $125,000 with the plaintiff as surety. As additional security the Bank had pledged bonds, of the par value of [fol. 20] $12,000, with the Commonwealth.

Seven months after the Bank closed, the Commonwealth was paid $50,000 by the plaintiff on account of its liability as the Bank's surety.

Five months later a dividend of 40% was declared, and the Commonwealth received an additional $54,000 from the receiver.

A month after that, the Commonwealth sold the pledged securities for $12,411.44, and shortly thereafter the plaintiff paid the Commonwealth $18,588.56, or the balance of its deposit. In all the plaintiff paid the Commonwealth $68,588.56, not counting interest.

The plaintiff takes the position that it is entitled to dividends upon the basis of the full amount of its principal's deposit in the Bank ($135,000). The receiver contends that the dividend should be on a basis, not of the full amount

of the deposit, but either (a) of the actual amount paid by the plaintiff to the Commonwealth in discharge of its suretyship liability ($68,588.56), or (b) of the amount of the deposit reduced by the amount of the Commonwealth's recovery from the pledged collateral ($12,411.44). Upon this latter theory, the basis of the dividend would be $122,588.66. The receiver has made tenders in accordance with both theories.

In stating the general principles which apply to this case it will be convenient to use the term "the creditor" when referring to the creditor secured by the surety bond (here the Commonwealth), and the term "general creditors" collectively for all other creditors entitled to share in dividends. The Bank is, of course, the debtor, and the plaintiff the surety.

The case before us is that of a surety asserting its right to dividends upon the whole claim of the creditor whom it secured, and to the benefit of the rule which would allow the creditor dividends on its claim without reduction by the realization from collateral. The creditor has received full payment of his claim. Part of it was paid by the debtor; part of it was realized from the debtor's collateral; and the surety has paid the balance. The debtor is insolvent.

[fol. 21] It is highly important to have clearly in mind that the surety is claiming subrogation—that is, substitution in place of the creditor. It also has (but is not here asserting) a direct claim against the debtor, as a creditor in its own right, by virtue of the debtor's implied agreement to indemnify it for any payment which it might be required to make under the contract of suretyship. The distinction between the two kinds of claims is pointed out clearly in Mellette etc. Co. v. H. Poehler Co., 18 F. (2d) 430.

The doctrine of subrogation is a device adopted or invented by equity to provide that debts ultimately will be discharged by those who in good conscience ought to pay them. Conversely, it is an appropriate means of preventing unjust enrichment. If a surety is made to pay, it is only just that he should have full reimbursement, out of the assets of the principal debtor, so far as it can be given him without injustice to others. The rights and interests which must be balanced in determining what is a just distribution are those of the surety, the creditor whom he has secured, and the general creditors.

As long as the creditor remains unpaid in whole or in

part it would be obviously unfair and unjust to him to permit the surety to receive any part of the estate of an insolvent debtor. To do so would decrease the creditor's dividend by his proportionate share of the payments to the surety, and thus allow the surety to compete against him—in derogation of the purpose of his contract of suretyship.

However, when the creditor has received everything due him and his claim has been discharged, there is no further reason, so far as he is concerned, why the surety's right to reimbursement should be suspended. This is, of course, true whether the creditor has been paid in whole by the surety or whether part of his claim has been recovered from the debtor or the debtor's collateral. There may have been some confusion about this formerly, but there is no doubt at the present time that where the claim of the creditor has been satisfied, from whatever source, surety is entitled to subrogation.

The creditor, having been paid, and so eliminated as a [fol. 2?] factor in the problem, it remains to balance the surety's rights and the interests of the general creditors. It is not easy to arrive at any solution which is entirely satisfactory and leaves one free from doubt as to the justice of the result. On the one hand, if the surety be allowed dividends on the full amount of the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis of his claim, then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim.

On the whole, it seems to me that, if the real objective of the doctrine of subrogation be kept in mind, we come closer to distributing the loss fairly and avoiding unjust enrichment of any interest by allowing the surety to claim on the basis of the full amount of the creditor's claim. By so doing it may be possible to reimburse him fully, and still do entire justice to the general creditors—for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement

with which they had nothing to do and which was purely fortuitous so far as they are concerned. To hold otherwise would really be to deny the surety subrogation altogether. If he be limited to the actual amount that he has expended or has contributed toward the payment of the creditor's claim, then he might as well come in as a direct creditor by virtue of the debtor's obligation to indemnify him.

Of course, a subrogated surety who has paid less than the entire amount of the creditor's debt will never be allowed to recover more than he has actually advanced, but, until he is made whole I see no reason why he should not be clothed with all the creditor's rights and remedies as they stood at the time of the debtor's insolvency.

This brings us to the question of the effect of the creditor's realization from the sale of the collateral. The creditor in this case had the right to prove and receive dividends [fol. 23] upon its full claim, as it stood at the time of the debtor's insolvency, without crediting collections from collateral pledged to secure the debt. This was settled beyond dispute in Merrill v. National Bank of Jacksonville, 173 U. S. 131, as the rule for the ratable distribution of the assets of an insolvent national bank. If the subrogee is to be placed as far as justly possible in the precise position of the one to whose rights he is subrogated, then he should be entitled to assert those rights as they stood at the date of insolvency, and the basis for his dividends, no more than that of the creditor, should not be cut down by the realization on collateral.

I am therefore of the opinion that the plaintiff is entitled to participation in the liquidation of the Bank on the basis of $135,000, or the full amount of the Commonwealth's claim, save that in no event can it receive more than it has actually paid the Commonwealth.

If the foregoing view of the plaintiff's rights is correct, there is no reason why interest should not be allowed. The dividend was declared and became payable immediately thereafter. It was never tendered to the plaintiff in full, nor was the partial tender in a form which the plaintiff could accept without waiving its rights to the balance.

Counsel fees are not allowable to the plaintiff.

The parties may submit an order for judgment in accordance with the foregoing opinion.

[fol. 24] Notes

(1) I do not regard the Pennsylvania decisions as controlling. What is involved here is the distribution of the assets of an insolvent national bank. Under the Federal Banking Law, distribution is to be "ratable," and it is for the Federal Court to determine what that means in each particular case. Of course, in so doing, considerations of underlying equitable principles as well as fairness and justice to all interests govern.

(2) The defendant relied principally upon two decisions of Circuit Courts of Appeals in other Circuits.

Ward v. First National Bank of Caruthersville, 76 F. (2d) 256, was a case in which the surety (not the creditor) held collateral pledged by the debtor. It is perhaps distinguishable upon that and the further ground that what was really involved was the surety's rights as a direct creditor of the debtor upon the latter's contract to indemnify it (though the Court seems to have observed no distinction between this right and the equitable remedy of subrogation). At any rate, the practical effect of the decision was to deny the surety the right of subrogation.

Md. Cas. Co. v. Cox, 104 F. (2d) 354, is, at any rate so far as certain statements contained in the opinion are concerned, in conflict with the principles upon which I have reached my conclusion in the present case. The Court there said, referring to a surety who had paid part of the creditor's claim (the balance having been recovered from other sources and the creditor paid in full), "It is as though the appellant had purchased a part of the debt. It did not pay the whole debt and is not entitled to collect upon the whole debt * * *." I can only say that, as applied to a case in which the creditor had been made whole, I can find no other authority for this statement of the law. It limits the surety to his claim on the debtor's contract of indemnity and, although the creditor is no longer interested, denies the surety the remedy of subrogation. It seems quite clear that the decisions go to this length only where the creditor's debt has not been [fol. 25] discharged. The Court in the Cox case also pointed out that there were other sureties on the same debt, and that to allow each of them to prove separately on the basis of the entire debt would be unfair and a duplication. No doubt it would be, but there should be no difficulty, under equitable rules, in pro-rating between sureties in a situation

of that kind. In the present case the question does not arise, because the plaintiff is the only surety.

The question does not seem to have been dealt with in this Circuit. Piedmont Coal Co. v. Hustead, 294 F. 247, would seem to indicate that the Court felt that a surety who has paid part of the claim is entitled to subrogation by way of substitution to the entire claim, even in a case where the creditor voluntarily remitted about 10% of the claim to the debtor, and so was not quite paid in full. However, I do not go so far as to say that I regard this case as dispositive of the present one, because it is not clear to what extent subrogation was allowed.

(3) It is a fact that the Commonwealth made an assignment of its entire claim to the plaintiff, but, inasmuch as I have fully sustained the plaintiff's position, upon the ground that it is entitled to be substituted for the Commonwealth by subrogation, it is unnecessary to consider whether, independently of that right, the plaintiff's position could have been sustained upon the assignment alone.

[fol. 26] In District Court of the United States, East[illegible] District of Pennsylvania

[Title omitted]

Stipulation and Motion for Substitution of Receiver Defendant—Filed March 18, 1940

And Now, this 14th day of March, 1940, it is stipulated by Rutledge Slattery, Esq., of counsel for plaintiff, and H. P. McFadden, Esq., counsel for defendants, that Edgar C. Dehne was duly appointed Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, on February 15, 1940 and that he has qualified as Receiver of said Bank and now is the duly constituted and qualified Receiver of said Bank, succeeding Benjamin Nieman; and said counsel respectfully move the Court to bring said Edgar C. Dehne upon the record in place and stead of Benjamin Nieman and make him a party defendant to this action.

(S.) Rutledge Slattery, Attorney for Plaintiff; (S.) H. P. McFadden, Attorney for Defendants.

[fol. 27] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Order of Substitution of Receiver Defendant—Filed March 18, 1940

And Now, this 18th day of March, 1940, upon consideration of the within Stipulation of counsel for plaintiff and defendants and upon their joint Motion, it is

Ordered that Edgar C. Dehne, who by due order of the Comptroller of the Currency of the United States on February 15, 1940, succeeded the defendant above named, Benjamin Nieman, as receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, be brought upon the record in place and stead of the said Benjamin Nieman and made a party defendant to this action.

By the Court:

Kirkpatrick, J.

[fol. 28] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Stipulation and Motion for Substitution of Receiver Defendant—Filed May 20, 1940

And Now, this 11th day of May, 1940, it is stipulated by Rutledge Slattery, Esq., of counsel for plaintiff, and H. P. McFadden, Esq., counsel for defendants, that L. M. Reed was duly appointed Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, on May 4, 1940 and that he has qualified as Receiver of said Bank and now is the duly constituted and qualified Receiver of said Bank, succeeding Edgar C. Dehne; and said counsel respectfully move the Court to bring said L. M. Reed upon the record in place and stead of Edgar C. Dehne and make him a party defendant to this action.

(S.) Rutledge Slattery, Attorney for Plaintiff; (S.) H. P. McFadden, Attorney for Defendants.

[fol. 29] IN DISTRICT COURT OF THE UNITED STATES, EASTERN DISTRICT OF PENNSYLVANIA

[Title omitted]

ORDER OF SUBSTITUTION OF RECEIVER DEFENDANT—Filed May 20, 1940

And Now, this 20th day of May, 1940, upon consideration of the within Stipulation of counsel for plaintiff and defendants and upon their joint Motion, it is

Ordered that L. M. Reed, who by due order of the Comptroller of the Currency of the United States on May 4, 1940, succeeded the substituted defendant above named, Edgar C. Dehne, as receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, be brought upon the record in place and stead of the said Edgar C. Dehne and made a party defendant to this action.

By the Court:

Kirkpatrick, J.

[fol. 30] IN DISTRICT COURT OF THE UNITED STATES, EASTERN DISTRICT OF PENNSYLVANIA

[Title omitted]

STIPULATION OF COUNSEL FOR ENTRY OF JUDGMENT—Filed May 20, 1940

And Now, it is stipulated and agreed between Rutledge Slattery, Esq., counsel for plaintiff (and H. P. McFadden, Esq., counsel for defendants, that

Whereas, by Opinion filed March 6, 1940 in the above case the Court directed that the parties submit a form of order for judgment in accordance therewith, and

Whereas, the parties have agreed that the judgment herein may embrace as well the matter of a certain dividend distributed by and from the estate of the defendant bank after the institution of this suit as the matters averred in the complaint,

Therefore:

1. It is admitted that on the 5th day of February 1940 the Receiver of the defendant bank distributed a further

dividend of five per cent (5%) to creditors of said bank, and that said dividend has not been paid or tendered to the plaintiff upon the basis of $135,000 or any other principal basis or amount.

2. For the purpose of judgment in this suit the said dividend may be taken in all respects as having been averred and specifically claimed in the complaint, and the sum due and payable to the plaintiff by the defendants as and for said dividend may and shall be $6,750, being 5% of $135,000 [fol. 31] in accordance with the Opinion of the Court that the plaintiff's dividends are payable upon the sum of $135,000 until the plaintiff shall have received in dividends the sum of $68,588.56.

3. For the purpose of judgment in this suit legal interest shall be due and payable to plaintiff upon said $6,750 principal sum of said dividends, from the aforesaid date of payment to other creditors to the date of payment to plaintiff, in accordance with the Opinion of the Court that interest is due the plaintiff upon dividends due and unpaid to it.

4. The annexed form of order for judgment shall be submitted to the Court for approval and entry, in pursuance of the direction of the Court that the parties prepare and submit a form therefor.

5. Nothing herein shall prejudice or affect the right of the defendants to appeal from the judgment to be entered herein.

In Witness Whereof, said respective attorneys have hereunto set their hands the 13th day of May, 1940.

(S.) Rutledge Slattery, Attorney for Plaintiff, (S.) H. P. McFadden, Attorney for Defendants.

[fol. 32] In District Court of the United States, Eastern District of Pennsylvania

Civil Action No. 514

American Surety Company of New York, Plaintiff,

vs.

The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, Substituted Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, Defendants

Order for Judgment—Filed May 20, 1940

This cause came on regularly to be heard before the above entitled court, Honorable William H. Kirkpatrick, Judge Presiding, on the 8th day of November, 1939, upon the complaint of plaintiff and on a stipulation which for all practical purposes amounts to an amendment of the complaint and an answer admitting all fact allegations, and by agreement of counsel that the court should dispose of the case thereon as on a rule for judgment on the pleadings. Rutledge Slattery, Esq. appearing on behalf of the plaintiff, and H. P. McFadden, Esq. appearing on behalf of the defendants. No testimony having been introduced but the cause having been submitted upon the complaint and stipulation and having been argued orally and upon briefs, and the court being fully advised in the premises, and having signed and filed herein its findings of fact and conclusions of law, and having directed that the parties submit a form of order for judgment in accordance therewith;

Now, therefore, by reason of the law and the findings aforesaid, and the annexed stipulation of counsel for the parties,

It is Hereby Ordered, Adjudged and Decreed:

1. That the defendant, L. M. Reed, Substituted Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, is hereby ordered and directed to pay to the plaintiff dividends upon the sum of $135,000, at the rate at which dividends have been paid or are payable to other depositors and creditors of said bank, until there shall so have been paid to the plaintiff the sum of $68,588.56.

[fol. 33] 2. It is further ordered, adjudged and decreed that the plaintiff do have and recover from the defendants, and each of them, plaintiff's costs herein incurred.

3. It is further ordered, adjudged and decreed that the plaintiff do have and recover from the defendants, and each of them, interest at the rate of 6% on $27,000 from December 10, 1935, and interest at the rate of 6% on $13,500 from July 16, 1938, and interest at the rate of 6% on $6,750 from February 5, 1940, until the plaintiff shall have received payment of all dividends heretofore declared by said defendants and not as yet paid to the plaintiff in accordance with said findings of fact and law filed in this matter on March 6, 1940.

By the Court:

Kirkpatrick, J.

[fol. 34] IN DISTRICT COURT OF THE UNITED STATES, EASTERN DISTRICT OF PENNSYLVANIA

[Title omitted]

NOTICE OF APPEAL—Filed June 18, 1940

Notice is hereby given that The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, Substituted Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, Defendants above named, hereby appeal to the Circuit Court of Appeals for the Third Circuit from the granting of the Plaintiff's Motion for Judgment on the Pleadings and the entering of the following Order for Judgment in this case on May 20, 1940, in favor of the Plaintiff:

"It is Hereby Ordered, Adjudged and Decreed:

1. That the defendant, L. M. Reed, Substituted Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, is hereby ordered and directed to pay to the plaintiff dividends upon the sum of $135,000, at the rate at which dividends have been paid or are payable to other depositors and creditors of said bank, until there shall so have been paid to the plaintiff the sum of $68,588.56.

2. It is further ordered, adjudged and decreed that the plaintiff do have and recover from the defendants, and each of them, plaintiff's costs herein incurred.

3. It is further ordered, adjudged and decreed that the plaintiff do have and recover from the defendants, and each

of them, interest at the rate of 6% on $27,000 from December 10, 1935, and interest at the rate of 6% on $13,500 from July 16, 1938, and interest at the rate of 6% on $6,750 from February 5, 1940, until the plaintiff shall have received payment of all dividends heretofore declared by said defendants and not as yet paid to the plaintiff in accordance with said findings of fact and law filed in this matter on March 6, 1940.

By the Court:

Kirkpatrick, J."

[fol. 35] (S.) H. P. McFadden, Attorney for Defendants, 112 East Third Street, Bethlehem, Pennsylvania.

[fol. 36] IN DISTRICT COURT OF THE UNITED STATES
EASTERN DISTRICT OF PENNSYLVANIA

[Title omitted]

STIPULATION AS TO RECORD ON APPEAL—Filed July 25th, 1940

And Now, it is stipulated and agreed between Rutledge Slattery, Esq., counsel for plaintiff and H. P. McFadden, Esq., counsel for defendants, that the following be included in the record on appeal to the United States Circuit Court of Appeals for the Third Circuit, in the above matter:

Docket Entries.
Complaint.
Motion to Dismiss and notice of motion.
Stipulation of counsel as to certain facts.
Opinion of the Court granting judgment for plaintiff on the pleadings.
Stipulation of counsel and Order of Court substituting defendant (March 18, 1940).
Stipulation of counsel and Order of Court substituting defendant (May 20, 1940).
Stipulation of Counsel as to entry of judgment.
Judgment in favor of plaintiff.
Notice of defendants' appeal with date of filing.

In Witness Whereof, said respective attorneys have hereunto set their hands the 25th day of July, 1940.

(S.) Rutledge Slattery, Attorney for Plaintiff; (S.) H. P. McFadden, Attorney for Defendants.

[fols. 37-38] In District Court of the United States, Eastern District of Pennsylvania

[Title omitted]

Order Extending Time to File Record—Filed July 31, 1940

And Now, July 31st, 1940, it is hereby ordered that the time for filing the record on appeal and docketing the action in the above matter, (the period of forty days from the date of the notice of appeal ending on July 28, 1940), be extended until August 7, 1940.

(S.) Kirkpatrick, J.

[fol. 39] In United States Circuit Court of Appeals for the Third Circuit

No. 7518—October Term, 1940

American Surety Company of New York,
Plaintiff-appellee,

vs.

The Bethlehem National Bank of Bethlehem, Pa., and L. M. Reed, Substituted Receiver of The Bethlehem National Bank of Bethlehem, Pa., Defendants-Appellants.

Minute Entry of Argument and Submission

And afterwards, to wit, the 23d day of October, 1940, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable William Clark, Honorable Charles Alvin Jones and Honorable Herbert F. Goodrich, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 27th day of November, 1940, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 40] IN UNITED STATES CIRCUIT COURT OF APPEALS,
FOR THE THIRD CIRCUIT

[Title omitted]

OPINION—Filed November 27, 1940

Before Clark, Jones and Goodrich, Circuit Judges

GOODRICH, Circuit Judge.

At the closing of the Bethlehem National Bank of Bethlehem, Pa. the Commonwealth of Pennsylvania had on deposit $135,000. It was secured by the bank's bond for $125,000 with the plaintiff as surety. As additional security the bank had pledged bonds with the Commonwealth, par value of which was $12,000. These bonds were sold for $12,411.44. The Commonwealth received the first dividend of 40% in the course of liquidation of the bank and the plaintiff paid the Commonwealth the balance. The total amount paid by the plaintiff, not counting interest, was $68,588.56.

[fol. 41] The question before the court on this appeal is the basis upon which the plaintiff surety might prove and receive dividends. Plaintiff takes the position that it is entitled to dividends upon the full amount of its obligee's original bank claim which was $135,000. The court below, after a carefully prepared and thoughtfully reasoned opinion, sustained the plaintiff's view. The receiver contends that plaintiff is entitled to participate in the liquidation of the bank to the extent of a claim of $68,588.56, the amount it actually paid to the Commonwealth. There is also the question of whether the plaintiff is entitled to interest upon further dividends which have been declared and paid to other creditors, but which the plaintiff has not received.

The difficulty with regard to the decision is clearly stated by the trial court in this language: "It is not easy to arrive at any solution which is entirely satisfactory and leaves one free from doubt as to the justice of the result. On the one hand, if the surety be allowed dividends on the full amount of the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis

of his claim, then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim."

Nobody disputes the general right of a surety who pays a principal debtor's obligation to reimbursement and indemnity from the debtor whether expressly provided by contract or not. Nor does either party to this litigation dispute the general doctrine by which a surety who pays a creditor is subrogated to the creditor's rights. Restatement, Restitution § 162. The question here is much narrower, for it has to do, not with the broad principles of sub-[fol. 42] rogation, but with the rights of a surety who has paid a part of a claim against a national bank which is in liquidation. Both the lower court and the parties agree that the Pennsylvania decisions are not controlling because what is involved here is the distribution of assets of an insolvent national bank. Again to quote from the opinion below: "Under the federal banking law distribution is to be 'ratable' and it is for the federal court to determine what that means in each particular case. Of course, considerations of underlying equitable principles as well as fairness and justice to all interests govern".

One can make a formally logical argument in support of the surety's position. In Merrill v. National Bank of Jacksonville, 173 U. S. 131 (1898), it was held by the Supreme Court, though not without very vigorous dissent, that the "equity rule" was the one to be applied as between a debtor and the creditors where a national bank was in liquidation. By that decision a creditor was permitted to prove in the liquidation proceedings for the full amount of his claim notwithstanding he was protected by collateral which covered a large part of it. That decision, of course, binds this court.[1] But that case did not concern a surety and, therefore, is not directly in point here. However, if a surety, upon paying the creditor, is entitled to step exactly into the creditor's shoes by the doctrine of subroga-

[1] But an interesting paper by Mr. Ralph E. Clark in 15 Ill. L. Rev. 171, 180, suggests that a serious question is presented whether the Supreme Court would continue to support the "chancery" rule.

tion, it is arguable that he has all the rights which the creditor had, including the right to prove for the full amount of the claim. As a possible makeweight it can be added that the surety in this case took an assignment from the creditor, after the surety had paid the sum due the creditor. This makeweight, however, has no added force since, at the time of the assignment, the claim had been discharged. We do not think that the assignment added anything to the rights which the surety already had. See Louisville Trust Co. v. Royal Indemnity Co., 230 Ky. 482, 20 S. W. (2d) 71 (1929). [fol. 43] The flaw in the argument is the major premise that subrogation involves a complete assimilation by the one subrogated of all of the creditor's rights. It is another illustration of the point that one can get out of a major premise all that he puts into it. Subrogation is not an inflexible legal concept nor a hard and fast rule like that of the common law which required words of inheritance to create an estate in fee simple. It is simply an exercise of the equitable powers of a court and is allowed "only when it does not conflict with the legal or equitable rights of other creditors of the common debtor; and the principle is one of equity merely, and will be carried out in the exercise of a proper equitable discretion, with a due regard to the legal and equitable rights of others" Sheldon on Subrogation (2d ed. p. 5). For instance a surety company has recently been held not to be entitled to subrogation to the Commonwealth's preference over other depositors. South Philadelphia State Bank's Insolvency, 295 Pa. 433, 145 Atl. 520 (1929). Comment (a) of § 138 of the Restatement of Security, Tent. Dr. No. 4, states that "Subrogation is based on general principles of justice and does not spring from contract although it may be confirmed or qualified by contract. It is a mode which equity adopts to compel the discharge of a debt by the one who in good conscience ought to pay it. * * * Subrogation, as a creation of equity is subject to the limitation that it will not be allowed where it will prejudice the creditor or be inequitable to third persons."[2]

What, then, is the equitable rule to apply to this surety company to secure the "rateable distribution" required by

[2] The right of the surety to subrogation is stated to exist to the extent that he has contributed to the satisfaction of the creditor; Restatement, Security, Tent. Dr. No. 4, § 138.

the statute? We are not faced here with the problem of the choice between the "equity rule" and the "bankruptcy rule" involving the rights to participation by secured creditors.[3] We should not be free to choose in that situation [fol. 44] unless the Merrill case, which followed the equity rule, has been abandoned.

But the claimant here is not the secured creditor but his surety.[4] Considerations which tend to support the view that the secured creditor should not lose the benefit of his diligence in obtaining security, when it comes to proving his claim against the estate of an insolvent are inapplicable here. The risk that the debtor bank might become insolvent was the very thing which the surety company insured against and presumably was paid for so doing. That was the same risk which was taken by the unsecured depositors in the bank who, along with the surety, now seek an apportioned share of the bank's assets. There is only so much money to go around; the more one gets the less someone else will receive. The surety and the depositors shared the same risk. It seems fair that they should share, in partial compensation for their loss, on the same basis. The basis on which the depositors share is the proportion of their actual loss, the amount of their deposits. The surety's actual loss is the same that it paid out, which was $68,588.56. This, we think, is the basis on which it is entitled to claim. The plaintiff argues that such a rule penalizes the surety for prompt performance of his obligation. We think the contrary is true. If the surety wants to prove for the full amount it can do so by paying promptly the amount of the obligation for which it stands as surety. The amount received by the Commonwealth prior to payment by the surety did not hurt the surety because it reduced, by that much, what the surety had to pay.

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[3] For discussion of the merits of the two rules see Note 8 Minn. L. Rev. 232; Fred T. Hanson, A Secured Creditor's Share of an Insolvent Estate, 34 Mich. L. Rev. 309; Clark article cited in footnote I.

[4] Present day decisions abound with statements to the effect that the commercial surety, unlike the personal and often gratuitous surety, is not the special favorite of the law. See Sokoloff v. Fidelity & Casualty Co., 288 Pa. 211, 215, 135 Atl. 746 (1927); Annotations in 12 A. L. R. 382; 94 A. L. R. 876.

The result reached is in accordance with the decisions of Circuit Courts of Appeals in the Eighth and Sixth Circuits with the Sixth Circuit case directly in point. Ward v. First National Bank, etc., 76 F. (2d) 256 (C. C. A. 8, 1935); Maryland Casualty Co. v. Cox, 104 F. (2d) 354 (C. C. A. 6, 1939).

[fol. 45] The second point in the case raises the question whether the surety company is entitled to interest on the dividends payable to and received by the other creditors, but not by the surety. This applies to the second, third and fourth dividends. The receiver argues that the surety is not entitled to interest, at least on the second and third dividends, because plaintiff refused to take dividend offers made to it. The surety says that it was asked to sign a receipt admitting that the amount paid be accepted as a dividend upon the full claim of the plaintiff, which the receiver endeavors to explain by saying it "was no more than a general practice employed by the defendant bank" and admits that no actual tender of the dividends was made. The plaintiff company was entitled to dividends and the receiver of course does not dispute that fact. We think it clear that under these circumstances the surety's claim for interest was well founded and that the interest on its dividends should be allowed from the time such dividends were declared.

The judgment of the District Court is reversed and the cause remanded for further proceedings.

A true Copy:

Teste:

—— ——, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 46] In United States Circuit Court of Appeals for the Third Circuit, October Term, 1940

No. 7518

American Surety Company of New York, Appellee

vs.

The Bethlehem National Bank of Bethlehem, Pa., and L. M. Reed, Substituted Receiver of the Bethlehem National Bank of Bethlehem, Pa., Appellants

Judgment—Filed November 27, 1940

On appeal from the District Court of the United States for the Eastern District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby reversed, with costs, and the cause is remanded to the said District Court for further proceedings.

Herbert F. Goodrich, Circuit Judge.

Philadelphia, November 27, 1940.

[File endorsement omitted.]

[fol. 47] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 48] Supreme Court of the United States

Order Allowing Certiorari—Filed March 31, 1941

The Petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

IN THE

Supreme Court of the United States

October Term, 1940.

No. —— .

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania,
Respondents.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals, Third Circuit, and Brief in Support Thereof.

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Counsel for Petitioner.

...rnational, 230 Chestnut St., Philadelphia

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IN THE

Supreme Court of the United States.

October Term, 1940.

No.

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, AND L. M. REED, AS RECEIVER OF THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, THIRD CIRCUIT.

This is a petition for writ of certiorari to the United States Circuit Court of Appeals, Third Circuit, involving a decision by that Court in the case of *American Surety Company of New York v. The Bethlehem National Bank of Bethlehem, Pennsylvania and L. M. Reed, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania,* Appellants, reported at 116 F. (2d) 75, wherein the Circuit Court reversed a decision of the District Court for the Eastern District of Pennsylvania, reported in 33 F. Supp. 722.

QUESTION PRESENTED.

The case presents the following question:

1. Did the U. S. Circuit Court of Appeals, in reversing the District Court, err in holding that petitioner as sub-

rogee and assignee of a secured depositor of respondent national bank is entitled to payment only of dividends declared following subrogation and assignment and calculated on the actual payment by petitioner to such depositor, and not to payment of such after-declared dividends upon the entire proved deposit amount or at least to dividends on such actual payment amount equal in aggregate percentum to all dividends declared since date of insolvency?

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The facts in the case are not disputed and, from the averments of the complaint (R. 2-7) admitted by stipulation in lieu of answer (R. 11-13) may be summarized as follows:

Petitioner is a New York corporation with its principal offices at New York City. It is engaged in the business of suretyship. Respondents are an insolvent national bank and its receiver (hereinafter called the Bank and the receiver).

The petitioner was surety upon a bond for $125,000 given by the Bank to secure deposits of the Commonwealth of Pennsylvania. As additional security the Bank had pledged with the Commonwealth bonds of $12,000 par value. The Bank closed on March 15, 1933, when the Commonwealth's deposit was $135,000.

The Commonwealth duly filed with the receiver its proof of claim for $135,000. That amount was thereafter paid to it in full as follows: By petitioner, $50,000 on account of petitioner's liability as surety, on October 16, 1933; by the receiver, $54,000 as first dividend of 40 per cent. of its deposit from the estate of the Bank, on March 27, 1934; by proceeds of the Commonwealth's sale of the pledged bonds, $12,411.44 on April 23, 1934; by petitioner, $18,588.56 balance (plus certain interest) in April 1934.

The petitioner thus paid to the Commonwealth $68,588.56, not counting interest.

By writing dated May 10, 1934 and lodged with the received on June 8, 1934 the Commonwealth assigned to the petitioner its filed claim of $135,000 against the Bank. Since that date three further dividends have been declared and paid by the receiver to other creditors, as follows: the second dividend, of 20 per cent., on December 12, 1935; the third, of 10 per cent., on July 16, 1938; and the fourth, of 5 per cent., on February 5, 1940. The petitioner claimed to be entitled to payment of each of them on the basis of $135,000 as the amount of the deposit of the Commonwealth at date of insolvency of the Bank, for which the Commonwealth had proved in the receivership. The receiver refused to pay the petitioner on that basis and never has paid any dividend to the petitioner on any basis. At various dates, and always upon condition that the petitioner acknowledge full payment, the receiver offered to pay the second dividend on the basis of $122,588.56 (deposit minus collateral proceeds) less an asserted overpayment of the Commonwealth on the first dividend, and subsequently offered to pay the same second dividend on the basis of $68,588.56, and to pay the third dividend on the basis of $122,588.56 without deduction. No overture was made by the receiver on any basis as to the fourth dividend (which was distributed to other creditors during the pendency of this suit and incorporated herein by stipulation, R. 21-22).

On September 13, 1939 this suit was brought by the petitioner in the District Court for the Eastern District of Pennsylvania for recovery of dividends on the basis of $135,000 and of interest on the dividends from the respective dates of their payment to other creditors of the Bank. Stipulation in lieu of answer and for determination as on a rule for judgment on the pleadings having been filed, the District Court on March 6, 1940 ruled in favor of the petitioner as to both dividend basis and interest on dividends, and judgment therefor was entered on May 20, 1940. Upon

appeal the Circuit Court of Appeals for the Third Circuit on November 27, 1940 reversed the judgment, held the proper dividend basis to be $68,588.56 only and that the second, third and fourth dividends declared in the insolvency should be paid to petitioner on that sum, held the award of interest on dividends to be proper, and remanded the cause for further proceedings accordingly. The mandate has been stayed in that court.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

1. The Decision of the Circuit Court Reversing the District Court Is Upon an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by This Court.

This Court has not as yet passed upon the precise question of what basis should be used in and for distribution to a subrogated surety of dividends from the estate of an insolvent national bank. The question is one strictly of federal law, for this Court held in *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, that the National Banking Act furnishes an exclusive code for the distribution of the assets of an insolvent national bank. The importance of the question rests in the fact that it is of nationwide incidence because invariably it arises in every case of national bank insolvency wherein any creditor has been secured by, and is to any extent made whole through, suretyship. That the question needs to be settled by this Court in the interest of certainty in the law, seems to be clear from the striking vacillation by the Office of the Comptroller of the Currency in this very case: The Comptroller, through the receiver, proposed in December 1935 to pay a dividend to petitioner on the basis of $122,588.56, minus an asserted overpayment on a prior dividend (R. 8). Seven months later, in July, 1936, he proposed to pay the same dividend on the basis of $68,588.56, citing only an *interim*

decision of the Eighth Circuit Court (R. 9, 10). In August, 1939, he proposed to pay another dividend on the straight basis of $122,588.56 (R. 6, Par. 14). In the case of the next dividend he made no proposal at all (R. 21, Par. 1). In this suit he returned to the position that dividends are payable on the sum of $68,588.56 (R. 11, Par. 15). Thus, though the Comptroller is the officer charged by this important Act with the administration of its provisions, he was wholly unable to discover in the present state of the law any constant rule whatever for his disposition of the question involved.

2. The Decision Ignores the Basis of Distribution Prescribed by Section 194 of the National Banking Act and Conflicts With the Principles Laid Down by the Decisions of This Court Interpreting Same.

The Act directs that the Comptroller shall pay ratable dividends from the assets of an insolvent national bank on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction.

This Court held in *U. S. v. Knox*, 111 U. S. 785, that the date of insolvency governs the fact and the amount of claims allowable against the bank. In *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, wherein the secured depositor was claimant, this Court held that to be ratable the dividends must be proportionate; that to be proportionate they must be paid on a uniform rule, that is, on one rule applicable to all alike and therefore manifestly upon the basis of claims against the bank as at the same point of time; that that point of time is the date of insolvency, at which claims take a proportionate vested interest in the assets of the national bank and after which no new debt can be made.

The decision below, on the contrary, holds that dividends should be paid not on the basis of $135,000, which was the claim of the Commonwealth-subrogor at date of insolvency and was by it filed and proved to the satisfaction

of the Comptroller, but on the basis of $68,588.56, a claim which neither existed at date of insolvency as prescribed by this Court nor was ever proved in the receivership so as to be cognizable by the Comptroller as a basis for dividend.

3. The Decision Is Contrary to the Ratable Dividend Requirement of the Act Even if the Basis for Dividends Was Properly Determined.

Even assuming that the $68,588.56 dividend basis fixed upon by the Circuit Court is not in conflict with the Act and its interpretation by this Court in point of principal basis, the decision results in utterly disproportionate distribution in point of dividend per centum. The Court below stated in arriving at the principal basis (R. 30):

> "The surety and the depositors shared the same risk. It seems fair that they should share, in partial compensation for their loss, on the same basis. The basis on which the depositors share is the proportion of their actual loss, the amount of their deposits. The surety's actual loss is the same that it paid out, which was $68,588.56. This, we think, is the basis on which it is entitled to claim."

The Court left completely out of account the coefficient which is absolutely necessary to ratable sharing, namely, the measure or extent of participation on whatever principal basis is selected. As the depositors received a forty per cent dividend on deposits before the petitioner succeeded the Commonwealth, and as the Court's decision awards to petitioner only dividends declared after that date, it seems inescapable under the decision that petitioner, though depositors recover 100% of their losses, could not possibly recover more than 60% of its conceded loss. Without regard, therefore, to the propriety of the dividend basis, the clear outcome under the decision cannot be other than a seriously unratable distribution.

The Act itself in terms requires, on the contrary, ratable distribution which this Court in *Merrill v. National Bank of Jacksonville, supra,* has held to mean distribution on a rule applicable to all alike.

4. The Decision Is in Conflict With the Decisions of Other Circuit Courts on the Same Matter.

The decision is contrary to the decision in *Fouts v. Maryland Casualty Company,* 30 F. (2d) 357, 358 (C. C. A. 4th), wherein the Court stated that "As only one primary debt exists, it follows that the rule of pro rata distribution, in the event of insolvency, requires that such primary debt be the basis of dividends." The court upon that reasoning decided that the surety there claiming should receive, through subrogation to the rights of the secured creditor, all dividends payable on the secured creditor's date-of-insolvency claim over and above the amount added to the surety's payment on the bond, necessary to satisfy his claim. The decision is also in conflict with the principle announced in *American Surety Company v. DeCarle,* 25 F. (2d) 20, that "Under the law, other creditors can claim no benefit from the fact that the Treasurer was secured in whole or in part, and they should not now be permitted to suffer a loss thereby."

WHEREFORE, your petitioner prays that a Writ of Certiorari be issued out of and under the seal of your Honorable Court directed to the United States Circuit Court of Appeals, Third Circuit, commanding the court to certify and transmit to this Court for review and determination on a date to be therein named, a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket No. 7518, American Surety Company of New York, Plaintiff-Appellee, v. The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, As Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania, Defendants-Appellants; and

that the judgment of said Circuit Court in said case be reversed by this Honorable Court, and that your petitioner have such other and further relief in the premises as to your Honorable Court may seem meet and just, and your petitioner will ever pray.

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The opinion of the District Court for the Eastern District of Pennsylvania reported in 33 F. Supp. 722, appears at pages 14 to 19 of the printed record. The opinion of the Circuit Court of Appeals, Third Circuit, reported in 116 F. (2d) 75, reversing the decision of the District Court, was entered November 27, 1940, and appears in the printed record at pages 27 to 31.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

FACTS.

Reduced to essentials the facts are simply that at the date of the closing of respondent Bank, the Commonwealth of Pennsylvania had on deposit in it the sum of $135,000, secured by the Bank's bond for $125,000 upon which plaintiff was surety and by $12,000 par value of United States bonds pledged by the Bank. The Commonwealth realized $12,411.44 from sale of the pledged bonds, received from petitioner in several payments a total of $68,588.56, not counting interest, and received from the Bank a liquidating dividend of 40%, or $54,000 upon its proof of claim for $135,000 filed with the Bank's receiver. Having been made whole by these receipts, the Commonwealth assigned its claim to the petitioner. Since then three further dividends have been declared in the liquidation of the Bank and have been paid to other creditors but not to the petitioner.

Petitioner brought this suit, upon theory of subrogation and assignment, for recovery of the after-declared dividends upon the basis of the $135,000 deposit and for recovery also of interest on the dividends from the respective dates of their payment to other creditors. The District Court sustained these positions, save of course only that in no event should petitioner receive in dividends more than the sum of $68,588.56 it had paid to the Commonwealth (R. 17), i. e. that in no event should the Bank through the media of the collateral and dividends pay more than the $135,000 deposit amount. Upon appeal the Circuit Court of Appeals, Third Circuit, while sustaining petitioner's position as to interest on dividends, held that the dividends should be calculated and paid only on the basis of the sum of $68,588.56 paid by petitioner to the Commonwealth (R. 30, 31).

THE LAW.

National Banking Act, 12 U. S. C. A. Sec. 194.

From time to time, after full provision has first been made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividend on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. 5236.)

SPECIFICATION OF ERROR.

Petitioner makes the following assignment of error which will furnish the basis for the following argument in support of the allowance of the writ.

1. The U. S. Circuit Court of Appeals, in reversing the District Court, erred in holding that petitioner as subrogee and assignee of a secured depositor of respondent national bank is entitled to payment only of dividends declared following subrogation and assignment and calculated on the actual payment by petitioner to such depositor, and not to payment of such after-declared dividends upon the entire proved deposit amount or at least to payment of dividends on such actual payment amount equal in aggregate percentum to all dividends declared since date of insolvency.

This assignment of error involves the following considerations of law, the facts being undisputed:

A. The basic requirement for distribution of assets of insolvent national banks.

B. The relation of such requirement to assignment of claims of national bank depositors after insolvency.

C. The relation of such requirement to subrogation to claims of national bank depositors after insolvency.

D. The uncertain effects of the disregard of the principle of distribution in the decision below.

ARGUMENT.

A. The Basic Requirement for Distribution of Assets of Insolvent National Banks.

The basic requirement for distribution in this case is that it be ratable. That is the requirement in the Act and as a principle it was stated and recognized by the trial court (R. 18) and by the Circuit Court (R. 29, 30) in this case. Both courts noted it as settled by the decision of this Court in *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, that a secured depositor of a closed national bank is entitled to dividends on the basis of the full amount of the deposit, without regard to collections from collateral

held for the debt. Having no decision of this Court on the question of the dividend basis to be employed where, as here, the secured depositor has been made whole and his surety has become entitled to dividends, the District Court below employed the primary debt of the bank, and the Circuit Court below employed the actual payment by the surety, as such basis.

It seems that the first inquiry should be into the *principles* of the law of national bank liquidation upon which the *Merrill* case was decided as it was by this Court, and the question ought then to be whether those principles point the way to disposition of the surety's claim.

In the *Merrill* case this Court, in addition to declaring the National Bank Act to be a full and exclusive code for the distribution of the estate of an insolvent national bank, reasoned that upon the insolvency of such a bank its creditors take and hold a vested interest in its assets in the ratio of their respective claims to the whole debt of the bank, because business must stop upon declaration of insolvency and no new debt can be made after that; that the requirement of ratable dividends means that dividends shall be paid proportionately, that is, on a rule of uniform application and therefore upon the basis of claims as at the same point of time. This Court concluded that the only claims the Comptroller of the Currency can recognize are those shown by proof satisfactory to him or by adjudication to have had their origin in something done before insolvency, and that the value of claims at the date of insolvency is to be taken as the basis of distribution. This last conclusion had been stated by this Court fifteen years before, in *U. S. v. Knox,* 111 U. S. 784.

We submit the limitations of the *Merrill* case principles to be that as a rule of law the Commonwealth deposit in this case in the sum of $135,000 at date of insolvency took at that date a fixed and vested interest in the assets of respondent bank in the ratio it bore at that date to the whole debt of the bank; that nothing done after that date

could upset either that debt structure or the proportionate place of that deposit account within it, and that therefore all dividends declared by the Comptroller until that deposit amount is paid must be paid upon the exclusive basis of it. In the decision below, on the contrary, there was substituted for $135,000 a dividend basis of $68,588.56 growing out of transactions which occurred after the date of insolvency, namely, payments by petitioner to the Commonwealth in an amount not determined by any rule of law of national bank liquidation. In such departure from the principles of the *Merrill* case, we submit, the Court fell into reversible error.

B. The Relation of Such Requirement to Assignment of Claims of National Bank Depositors After Insolvency.

It is a fact in this case, upon which the District Court did not rest its decision (R. 19 (3)), that the Commonwealth assigned its entire proved claim to petitioner. The Circuit Court below referred (R. 29) to the assignment as a "possible makeweight" which did not add anything to the rights petitioner already had. The Circuit Court cited only a Kentucky decision for this view (R. 29), although noting that the question is a federal question (R. 28). The Court also stated (R. 29) that at the time of the assignment the claim had been discharged, which we submit was plain error because it was the duty of the bank under the Act to pay the claim and it simply had not paid it. It is true that the assignment was dated May 10, 1934 (R. 13), following the date of the last payment by petitioner to the Commonwealth (R. 4, Par. 10), but it is admitted that the assignment was made for the value received by the Commonwealth from the petitioner (R. 4, Par. 11). Certainly, it is not for the debtor in any legal situation to profit by dealings between his creditor and another; his obligation is to pay his debt, in this case to pay dividends upon a deposit account of $135,000 existing at date of insolvency. Obviously the claim of any assignor is discharged so far

as the assignor himself is concerned. Moreover, in his letter of December 23, 1935, to petitioner (R. 8) the receiver in terms recognized the Commonwealth's claim of $135,000 as having been assigned to the petitioner in the premises.

We submit it to be inherent in the obligation of the respondent bank to pay dividends on $135,000, as similar obligation was interpreted in the *Merrill* case, that the obligation cannot be reduced by a subsequent assignment but on the contrary that the debtor bank must pay the assignee on the basis of the original deposit. If the secured creditor in the *Merrill* case had assigned his rights for any value the principles of that case seem clearly to prescribe payment of dividends to the assignee on the basis fixed, i. e. of the claim as at date of insolvency. That would be so whether the value paid for the assignment were one dollar or, as here, $68,588.56, because the debtor's burden cannot be changed after date of insolvency.

C. The Relation of Such Requirement to Subrogation to Claims of National Bank Depositors After Insolvency.

The District Court below rested upon subrogation its view that petitioner is entitled to dividends on the basis of $135,000, the Commonwealth's deposit (R. 19 (3)), and stated that to deny this right is in practical effect to deny the right of subrogation. The Circuit Court below rested its reversal of the judgment on the proposition that subrogation will not be allowed to the prejudice of other creditors and its application of that proposition to mean in result that other depositors shall receive here 40% more of their claims than petitioner shall receive of its payment in suretyship.

We submit on the contrary that the petitioner is entitled to subrogation to the primary debt itself, and that by the same token the decision below is in error for two particular reasons affecting the question of subrogation.

In the first place, the cardinal principle of national bank liquidation laid down by this Court in the *Merrill* case

collapses unless the Commonwealth deposit sum of $135,000 is employed as a dividend base until the Bank shall have paid that debt, no matter to whom. This Court having decided in 1898 that liquidation shall be carried out on the basis of debt existing at date of insolvency, consistency and legal certainty seem to command that any and every subsequent event relating to or bearing upon any deposit account must be accommodated to the ratable vested interest that deposit held at date of insolvency. Given the *Merrill* case principle of law, no "equity" could congruously exist or be raised after insolvency in other creditors to effect the discard of that fixed ratio.

In the second place, assuming that an "equity" of other creditors could override the law of the *Merrill* decision, we submit that no such equity exists in the present case. Manifestly the Commonwealth could have demanded continuing dividends on $135,000. That is exactly what the other creditors were bound to expect under the *Merrill* case holding itself. Yet upon a simple operation occurring after insolvency and with which the other creditors had nothing to do, viz., payment by petitioner to its obligee, it is said by the Circuit Court in effect that the other creditors may have a windfall, in the form of reduction of the competing account from $135,000 to $68,588.56. Surely no "equity" can be founded upon the circumstance of a suretyship purely fortuitous as to other creditors. Such was the reasoning of the District Court below (R. 16, 17), and we find no answer to it in the opinion of the Circuit Court. The holding of the Circuit Court if settled in the law would apparently tend to encourage delay and default by the surety to the end that the secured creditor might be caused to retain his position and thus receive dividends on the date-of-insolvency basis denied to the surety. Petitioner, though in terms described by respondents before suit as subrogee of the Commonwealth's deposit claim (R. 9), becomes subrogee without right of subrogation.

The Circuit Court reached its conclusion in spite of concession that in general a surety who pays a creditor is

subrogated to the creditor's rights (R. 29), and partially upon reference to a Pennsylvania decision (R. 29) in spite of the conceded irrelevance of Pennsylvania decisions (R. 28), and upon at least a collateral suggestion that this Court might not continue to follow the *Merrill* case (R. 28), although this Court repeated the rules of that case in the recent case of *Ticonic National Bank v. Sprague*, 303 U. S. 406. The decision is contrary to that in *Fouts v. Maryland Casualty Company*, 30 F. (2d) 357 (C. C. A. 4th) wherein the court said in ruling on the dividend basis where the surety was claimant and where, as here, the surety bond had been less than the secured creditor's deposit (p. 358):

> "As only one primary debt exists, it follows that the rule of pro rata distribution, in the event of insolvency, requires that such primary debt be the basis of dividends."

The decision conflicts also with the principle stated in *American Surety Company v. DeCarle*, 25 F. (2d) 20 (C. C. A. 9th) that "Under the law, other creditors can claim no benefit from the fact that the Treasurer was secured in whole or in part . . .", because it relieves the debtor bank here of its liability to pay $135,000 on the Commonwealth deposit account, to the wholly undeserved advantage of other creditors.

The Court below (R. 31) cited as in accord with the result of its decision the cases of *Ward v. First National Bank*, etc., 76 F. (2d) 256 (C. C. A. 8th) and *Maryland Casualty Company v. Cox*, 104 F. (2d) 354 (C. C. A. 6th), and stated that the *Cox* case is directly in point. Whether such result can stand in this Court is of course the ultimate question upon the present petition, but as to the two cases cited the following ought to be noted: The *Ward* case presented a different situation, for there the surety did not pay the deposit and claim succession to the obligee's rights in it; the surety himself held the bank's assets as collateral for the bank's obligation to the surety under the surety bond.

Having sold the collateral of the bank the surety turned over the proceeds to the depositor obligee together with the difference between such proceeds and the figure of the surety bond liability. Therefore when the surety paid there was no claim on file as in the present case, and its procedure was under the indemnity in the bond and not upon succession to the obligee's proved claim as in the present case. In the *Cox* case the surety received the same dividends on its payment to the secured creditor as the other creditors on their claims, which is not the result of the decision here. Moreover, the Court in the *Cox* case conceived and was influenced by a difficulty with our position which does not exist, stating that if two or more sureties contributed to the obligee they could not all claim dividends on the whole primary debt. Obviously, as the District Court below pointed out (R. 18), the problem would be solved by pro-rating their contributions to the controlling primary debt. Moreover, both the *Cox* case and the *Ward* case were decided after petitioner's rights in the case at bar arose, so that neither those decisions nor any other existed to gainsay the petitioner's contention in the beginning for the application of the *Merrill* case principles to the present claim . . . a circumstance further showing the newly unsettled condition of the law and further suggesting the necessity for its settlement by this Court.

Finally, the very reasoning in the opinion below upon ratability is not followed to a ratable result in the Court's decision. Though the Court fixes upon the petitioner's actual payment as a basis ratable with the "actual loss" of other depositors in the sum of their deposits and *though the admitted fact is that other depositors have been paid 75% of their claims through dividend, the decision below awards petitioner only 35% of its actual payment.* This, we submit is utterly inconsistent with the ratability required by the Act. The Court below says (R. 30):

> "If the surety wants to prove for the full amount it can do so by paying promptly the amount of the obli-

gation for which it stands as surety. The amount received by the Commonwealth prior to payment by the surety did not hurt the surety because it reduced, by that much, what the surety had to pay."

No authority is cited for such observation, and we know of none in the law. Its effect, we submit, is to rule this case upon facts contrary to those presented by the record, and to remake the parties' arrangements by supposing the petitioner actually to have given credit of $125,000 to the bank prior to insolvency instead of merely having, as is the fact, undertaken a contingent liability to that limit to a depositor, with the right to expect the bank as principal to meet the primary liability. It is true that this suit was brought for the dividends following the first dividend of 40% which had previously been paid to the Commonwealth, but it was so brought because the basis of the claim was the Commonwealth deposit itself. If the basis was misconceived, and a different one is applied in the event of the suit, certainly that different one must be pursued to the ratable distribution prescribed by the Act itself. We submit that the Circuit Court has plainly failed to apply equal percentage even to the basis it substituted for that asserted, and that on that score alone the Court fell into seriously prejudicial error.

D. The Uncertain Effects of the Disregard of the Principle of Distribution by the Decision Below.

There is ample ground in the law for the proposition that a fixed and certain rule of law should be adopted as against one that allows expediency and the caprice of parties in transactions to determine results.[1] The decision of this Court in the *Merrill* case is an example of such policy as applied to the law of national bank liquidation. In the

[1] A Note on the instant case in Vol. XL Col. L. Rev., No. 8, p. 1448 (Dec. 1940) collects the decided authorities and approves the decision as lending certainty to the law.

analogous situation of cosureties, it was held in *In re Thompson*, 300 Fed. 215 (W. D. Pa.) that a paying surety is entitled to recover from an insolvent cosurety on the basis of the creditor's full claim on a theory of subrogation, because (p. 217);

> "The application of this rule makes the rights of the paying surety fixed and certain, instead of uncertain and depending on the caprice or election of the creditor to proceed first against the insolvent, or against the solvent surety, causing different results to the paying surety."

The same principle is stated in *Chemical National Bank v. Armstrong*, 59 Fed. 372, 380 (C. C. A. 4) in fixing at date of insolvency the face of claims and the stoppage of interest. The surety in *City of Oakwood v. Hartford Accident and Indemnity Company*, 51 F. (2d) 717 (C. C. A. 6th) was held entitled to insist that the secured creditor preserve the security for the surety's benefit and claim dividends on the deposit without regard to deduction for collateral.

Under the rule contended for by petitioner there is the desirable certainty in the law, the debtor bank being held to the payment of the deposit, fixed as at date of insolvency, by means of dividends or collateral sale or both. Under the contrary rule of the decision of the Circuit Court, that the surety is limited to dividends on the amount he paid the depositor, not only must sureties inevitably be forced in practice to seek as large a measure of collateral as can be withdrawn from the bank's assets but the result will be determined by creditor election. For example:

The 35% in dividends on the sum of $68,588.56 which petitioner *happens* to have paid the Commonwealth—20%, 10% and 5%—would aggregate $24,005.99. The difference between the dividends and petitioner's payment would be $44,582.57, which would be its present unrecouped loss under the decision below.

Suppose instead that petitioner had paid the full amount of the bond—$125,000—to the Commonwealth be-

fore the bank paid to the Commonwealth the first dividend of 40%, and had arranged with the Commonwealth to sell the collateral, which brought $12,411.44 in this case (R. 4, Par. 9). The deposit being $135,000, the Commonwealth would have retained $10,000 of the collateral proceeds and turned over $2,411.44 to petitioner. That would have left petitioner with $122,588.56 net loss to recover by dividends payable by the bank on $125,000. The 75% in dividends on that sum—40%, 20%, 10% and 5%—would have returned to petitioner $93,750. The salvage to petitioner from these dividends and the collateral overplus would have totalled $96,161.44. The net unrecouped loss to petitioner would have been only $28,838.56, or $15,744.01 less than in the outcome of the rule of the decision of the Circuit Court. Moreover, petitioner would go on in the future taking greater dividends to salvage that lesser balance of unrecouped loss.

The foregoing examples could be multiplied according to any supposed form of concert between the surety and the obligee. The two given show the glaring difference of result produced, on the identical date-of-insolvency facts of the present case, by different handling not involving the bank or other creditors but only the surety and its secured creditor. Surely there is no ratable certainty in a rule permitting such results. Surely no "equity" of other creditors was violated any more in the second example than in the first. We contend that a rule that can be thus managed by parties after insolvency on the same date-of-insolvency facts is unsound and of a kind that ought not to be law.

Conclusion.

On the admitted facts the District Court was correct in holding that petitioner is entitled to dividends in the bank's liquidation upon the basis of the Commonwealth's deposit until the Bank shall have paid the amount of the deposit through collateral proceeds and dividends. The Circuit Court of Appeals should be reversed on its contrary holding

and in any event on its failure to award petitioner equal percentage in dividends even on the basis it substituted. It is accordingly submitted that the petition for certiorari should be granted.

Respectfully submitted,

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

October Term, 1941.

No. 29

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania,
Respondents.

BRIEF FOR PETITIONER.

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Counsel for Petitioner.
123 South Broad Street,
Philadelphia, Pa.

International, 236 Chestnut St., Philadelphia

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Respondents.

BRIEF FOR PETITIONER.

On March 31, 1941, this Court granted petition for writ of certiorari to the United States Circuit Court of Appeals, Third Circuit.

It is not here intended to repeat the argument set forth in the brief supporting the petition for writ of certiorari but rather to present as well further points supporting subrogation to the primary debt in this case.

Because it was settled by the decision of this Court in *Merrill v. National Bank of Jacksonville,* 173 U. S., 19 S. Ct. 360, 43 L. Ed. 640 that in the special case of national banks liquidation claims are fixed, and interests of creditors vest in the estate, at date of insolvency, we have argued that an "equity" could not possibly arise after insolvency in favor of other creditors to cause the abandonment of the date-of-insolvency debt ratio and defeat petitioner's substitution to the primary debt of $135,000

as a dividend basis. Other decisions of this Court indicate, we believe, that even if the *Merrill* case principles do not alone conclude the instant case, so as altogether to exclude inquiry into other creditors' "equity", no such equity either on sound policy should be sought or can here validly be discovered. Thus we urge that the decision of the Circuit Court was error not only because inconsistent with the *Merrill* case principles but because based upon an unsound assumption of equity of other creditors, as well of course as because the decision denies to petitioner an *equal per centum* of participation even on the dividend basis substituted by the Circuit Court in reversing the District Court (See Reason 3 for Petition).

Subrogation is defined as the "substitution, ordinarily of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt". *Sheldon on Subrogation,* 2nd Ed., Sec. 1. "The substitute is put in all respects in the place of the party to whose rights he is subrogated." *Ibid. Bouvier* (8th Ed., 3rd Revision, p. 3166) defines it as "the substitution of another person in place of the creditor so that the person substituted will succeed to all the rights of the creditor having reference to a debt due him."

Thus by definition petitioner ought to succeed to the right to dividends upon the primary debt of $135,000, for that admittedly was the right of the creditor. But the Circuit Court, differing with the District Court, said (R. 30) that it seemed fair that petitioner and other creditors should share on the basis of their respective actual losses, having "shared the same risk". The petitioner, we submit, did not "share the same risk" with the depositors,

for it had the right to expect the Bank to pay the Commonwealth's deposit and therefore it undertook a conditional risk only. The Commonwealth, not petitioner, was the creditor of the respondent Bank. Petitioner shared risk of insolvency, but not the risk of the same necessary effect in the event of insolvency.

That other creditors cannot complain of petitioner's substitution is brought out strongly in *Lidderdale's Executors v. Executors of Robinson*, 12 Wheaton 594, where this Court allowed full substitution to one co-endorser of a note against the insolvent estate of the other and, in dismissing the argument advanced by other creditors against such substitution, said (p. 595, 60):

> "What have the creditors of Robinson to complain of? They are only referred back to the situation in which they were relieved by the application of Smith's funds to the payment of the bill of exchange. If the bill of exchange still remained in the hands of the holder unsatisfied, his right to a priority from Robinson's Estate as to the moiety of the bill would be unquestionable, and if relieved from that state by the money of Smith, it is but right that Smith should have refunded to him that sum which they, without that payment, would certainly have been obliged to relinquish."

In the instant case the other creditors of the respondent Bank are, upon petitioner's substitution to the primary debt under the judgment of the District Court, merely "referred back to the situation in which they were relieved" by the application of petitioner's fund to the discharge of the deposit, because but for petitioner's payment the Commonwealth most certainly would have taken upon $135,000 the dividends awarded to petitioner on that basis in

the judgment here. What prejudice is it to them, then, that dividends on that sum should continue to the close of liquidation, and what right have they that the competing account should, in the unfinished course of the liquidation, fall from $135,000 to $68,588.56 by force of performance of a bond not given to them or in any wise for their benefit?

The policy noted by this Court in *Texas & Pacific Ry. v. Pottorff*, 291 U. S. 245, 54 S. Ct. 416, 78 L. Ed. 777, a case having to do with pledge of national bank assets, seems strictly pertinent and helpful toward sound decision in the instant case. There the general policy of the National Banking Act and principles of sound banking practice were held to prohibit pledge of such assets for private deposits because, as it was later referred to and expressed in *Inland Waterways Corp. v. Young*, 309 U. S. 517, 60 S. Ct. 646, (at p. 519):

> "To allow a withdrawal of assets of the bank from general availability would impair the bank's liquidity —its ability to meet unexpected demands by depositors—and thereby restrict the national banking system as a reliable instrument of national finance."

Surely that policy postulates the substitution of sureties to the primary debt, for unless such substitution is assured, and if sureties are to be confined instead to their rights in the collateral, the withdrawal of capital assets of national banks for the purpose of pledge must tend to be increased by the discouragement of suretyship as an alternative form of securing deposits of public funds. Sureties would be compelled to seek as large a fraction of actual pledge as they could possibly arrange in such transactions, in order to guard their eventual position in subrogation.

It is submitted that encouragement of the practice of meeting security demands by suretyship, a method which while it involves an operating expenditure does not tie up bank assets in creditors' hands, is the part of far sounder policy than the reverse—policy, too, that the Comptroller of the Currency ought fairly to welcome in the law of national bank operation.

Still another objection to the decision of the Circuit Court on point of sound law is that it tends to discourage the surety from discharging his bond. Since, under the Circuit Court holding, the surety would know that the debtor bank need pay dividends on the primary debt so long only as the secured creditor held it, he would quite naturally exert every effort to cause the creditor to retain its position in the estate and to postpone the day of substitution. Every form of arrangement of delay between creditor and surety would be invited to keep down the prospective irrecoverable loss of the surety and prevent the wholly fortuitous benefit extended the other depositors under the Circuit Court's decision. It would be a strange state of the law that would thus prompt delay in performance of the bond. This objection is not answered, we submit, by the observation of the Court below (R. 30) that "If the surety wants to prove for the full amount it can do so by paying promptly the amount of the obligation for which it stands as surety", because this observation cannot hold true in cases where payment of the bond amount would not make the creditor whole and because in any case the principal, not the surety, is the debtor and therefore in elementary justice ought to pay the debt. We contend that it begs the question thus to suggest that the surety can avoid the question by paying the debt.

It seems worthy of notice that at the time of the declaration of the first dividend in suit there was no authority against petitioner's position. On the contrary, the decision in *Fouts v. Maryland Casualty Co.*, 30 F. (2d) 357 (C. C. A. 4, 1929) had clearly declared the primary debt to be the proper basis for dividends to the surety and the only such basis consistent with the ratable dividend requirement of the Act. The very first decision to the contrary in the whole period following the *Merrill* case in 1898 was that of the Eighth Circuit Court in 1935 in *Ward v. First National Bank of Caruthersville*, 76 Fed. (2d) 256, followed by the decision of the Sixth Circuit Court in 1939 in *Maryland Casualty Co. v. Cox*, 104 F. (2d) 354. Were these two decisions sound we could not complain upon the circumstance that they followed in date the origin of the issue in the case at bar, but we submit that they departed from the long standing principles of the *Merrill* case, and, without repeating it here, we respectfully refer this Court to the comment of the District Court as to them (R. 18). and as to the proposition that there is no right in any depositor to expect their result (R. 16, 17). We point to the long period of the silence of the law on the question as indicating that no such right was conceived to exist, just as, we contend, none is pointed out in the decision of the Circuit Court here or in the two other Circuit Court decisions cited.

Should our contention for substitution to the primary debt be unsound in the judgment of this Court, the result of the decision below is still clearly erroneous, we submit, in that it denies to petitioner ratable participation even on the "actual payment" basis. The Circuit Court stated that in its opinion the actual payment by petitioner was

its loss in the sense that the amount of deposits was the depositors' loss and (R. 30) that "it seems fair that they should share, in partial compensation for their loss, on the same basis." Not adding "*to the same percentage extent*", this formula leaves petitioner with aggregate dividend award only of 35% to date, whereas it is admitted that the depositors have received 75% on their claims. Such a result is seriously and prejudicially unratable and in patent conflict with the Act, we contend, even if the principal basis were correct.

CONCLUSION.

It is respectfully submitted that the decision of the United States Circuit Court, Third Circuit, is erroneous and should be reversed and that the decision of the United States District Court for the Eastern District of Pennsylvania that

> "the plaintiff is entitled to participation in the liquidation of the Bank on the basis of $135,000, or the full amount of the Commonwealth's claim, save that in no event can it receive more than it has actually paid the Commonwealth."

should be sustained.

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Attorneys for Petitioner.
123 S. Broad Street,
Philadelphia, Pa.

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IN THE

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Respondents.

REPLY BRIEF FOR PETITIONER.

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Counsel for Petitioner.
123 South Broad Street
Philadelphia, Pa.

National, 236 Chestnut St., Philadelphia

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Respondents.

REPLY BRIEF FOR PETITIONER.

The argument contained in respondents' brief includes new matter conflicting directly with every position heretofore taken by respondents in this case, and other matter which similarly appears to call for reply by petitioner.

1. As to the Newly Asserted "Illegality" of a Portion of the Deposit.

For the first time in this case respondents advance the position that the basis for dividends to petitioner should be $62,500 only, on the theory that the deposit should not have been more than one-half of the depository bond. (Respondents' brief, pp. 10-14). There are, we believe, two clear answers to this position.

In the first place, decisional authority is to the contrary, for it shows that statutes such as those of Pennsylvania contained in respondents' brief and the appendix thereto, setting up requirements to control the relation of public deposits to the security therefor and to the capital of the bank,

have been enacted and are to be construed for the benefit of the public and *not of the bank.*

In *Capital Savings and Loan Association vs. Olympia Nat. Bank,* 80 F. (2d) 561 (C. C. A. 9, 1935) a *depositor* sought to enjoin a national bank receiver from paying further dividends to the State Treasurer of Washington on the ground, inter alia, that the security deposited with the treasurer was not as great as that required by the State statute and that the deposit was not in required relation to the capital and surplus of the bank. In affirming the dismissal of the Bill, the Circuit Court there said (p. 567):

> "Nor can the appellants complain that the state treasurer did not exact from the bank greater security, so that the state's deposit would be either seventy-five or ninety per cent of the amount pledged. That provision, we repeat, is for the protection of the state and not of the bank; for if the state treasurer had exacted even more security than he in fact received, the assets of the bank would have been further depleted by that much and the general creditors would be in worse situation than they now are.
>
> "To summarize our views under this heading therefore we hold that the appellants are entitled to invoke the state statutes for the purpose of ascertaining whether *any* security for public deposits is permitted by state law, and, if so, what kind, but not for the purpose of questioning the size of the public deposit or the *amount* of security given by the bank; for the provision of state law as to the amount of security or of public deposits are for the protection of the state and not of the banks."

Secondly, the position has its direct and continuous refutation in all the positions taken by respondents themselves throughout the instant case. *Before* the suit was begun the respondents first paid the Commonwealth a divi-

dend of 40% upon $135,000 and then recognized the petitioner as "subrogee of the deposit claim due the Commonwealth of Pennsylvania by the Bethlehem National Bank" (R. 9, Letter of Receiver to petitioner of July 11, 1936) and also recognized the deposit as having been "assigned" to the petitioner (R. 8, Letter of Receiver to petitioner dated December 23, 1935), and in the earlier instance treated the $135,000 deposit as the valid original base. In the case of the second letter (R. 9)the Office of the Comptroller of the Currency himself was quoted as having directed the use of the $68,588.56 basis for petitioner's dividends. A basis of $62,500 for dividends, as a basis equal to one-half the face of petitioner's bond, was never mentioned. The respondents' Answer speaks for itself, as their position *after* suit was begun (R. 11):

> "Paragraph 15. It is admitted that the plaintiff claims as alleged in this paragraph, but the *defendant contends* that the plaintiff is only entitled to be reimbursed *on the basis of the amount paid by the plaintiff to the Commonwealth.*" (Italics supplied)

Here was *affirmative contention* for a basis of $68,588.56 advanced in the trial Court by the respondents, and of course therefore treated in the decisions of both the trial Court (R. 14) and the Circuit Court (R. 27) as the respondents' position upon the issue of dividend basis. Of course also, no cross-petition for certiorari was filed in this Court on any basis, the Circuit Court having adopted the respondents' own said specific contention on that issue.

Therefore we contend that both the law and the record of this case defeat this new position of respondents. Reference may be made further to the reasoning enlisted by respondents under its head. Seeking, apparently, to make out that petitioner is a claimant against "innocent third parties" while itself guilty of negligence, respondents now suggest that subrogation should not attach (Respondents' brief, p. 13). First, wherein was petitioner "negligent"? Re-

spondents say frankly that they do not by any means suggest that petitioner "participated in, or in any way was causally responsible for, the making of said illegal deposits" (Ibid., pp. 12, 13); yet they say petitioner was negligent in not "supervising" the deposit account "to the extent of being kept constantly informed as to the balance thereof". There is no factual showing whatever in this record that petitioner did or did not procure that information, and therefore there is no factual foundation for the argument. Supposing nevertheless that petitioner did not procure it, surely the failure to avail of a simple possibility of information is not negligence where it is plain that the information could not be acted upon if procured. And, in the same connection, where is the "innocent party"? If petitioner had had the information it could not have restrained the State Treasurer of Pennsylvania from making excess deposits *or the respondent bank from accepting or retaining them.* That seems clear upon the decision in the *Capital Savings* case, supra, and also upon the statement of the Supreme Court of Pennsylvania o the subject of the statutes of 1897 and 1906 set forth by respondents (Brief, p, 11), in *Commonwealth v. Caldwell* 224 Pa. 103, 112, that "The purpose of this act was to throw around the state treasury additional *safeguards as a protection to the public funds".* It is the *respondent bank* that is the negligent and wrongful party here, in truth, because petitioner was helpless to control the deposit amounts but respondent was perfectly free to decline to receive them. Respondents say that petitioner's claim for dividends upon $135,000 is a result of the *making* of illegal deposits (Respondents' brief, p. 13). Rather, we submit, it is the result of the *acceptance* of such deposits by the respondent bank, for no deposit could have been made had respondent declined it.

Thus, we submit that the new position of respondent upon the basis of "illegality" amounts to no more than a statement by respondents as follows in effect: "We are telling you now that we accepted from the Commonwealth de-

posits making possible and actual the State treasurer's evasion of statutory requirements. We thus procured public monies for our own investment profit without the need for yielding up our capital assets as collateral, or paying higher suretyship premium, to secure them. We have not only enjoyed this double advantage by participating in an evasion of the statutes which you, the surety, could not prevent, but we have also recognized the whole deposit for the purpose of the dividend of 40% to the Commonwealth and have availed ourselves of your liability upon your bond and have seen you pay $68,588.56 upon that deposit out of your own funds. Subsequently we have joined issue with you, and forced you to litigate to last resort, upon an express theory on our part that you are entitled to dividends on the sum you so paid rather than on the deposit. Now, in the last resort, we tell you that we may pay you nothing, or that at most we ought to pay you upon $62,500, *because*, as we tell you now, we evaded the law for our profit in the past. We propose a premium upon our own evasion, in the form of saving in bond charges before and a reduction in our liquidation obligation now. You should have found us out before, though you could not have acted upon your information if you had, since the statute we evaded is for the protection solely of the public whom you have made whole agreeably to your promise."

The Commonwealth having been made whole and the *respondent bank* having been itself the wrongdoer in the transaction which thus worked out without loss to the public interest intended by the statute to be protected, there appears to be no room in this case for the maxim that where loss is sustained affecting two innocent parties the one making it possible should suffer it. (Respondents' brief p. 14)

2. As to the Payment for the Depository Bond.

Respondents are correct in observing, at page 14 of their brief, that the District Court mistakenly stated (in passing) that the Commonwealth paid for the depository

bond. Respondents are *not* correct in stating that petitioner in any way adopted this mistake in the petition for certiorari. Petitioner does not rely upon any such proposition of fact, nor—respondents' assumption at page 16 of their brief to the contrary notwithstanding—did the District Court. That part of the District Court's reasoning urged upon this Court in our petition for certiorari (p. 15) makes no mention of payment for the bond and in no way relies upon it. The Court said (R. 16, 17):

> "On the whole, it seems to me that, if the real objective of the doctrine of subrogation be kept in mind, we come closer to distributing the loss fairly and avoiding unjust enrichment of any interest by allowing the surety to claim on the basis of the full amount of the creditor's claim. By so doing it may be possible to reimburse him fully, and still do entire justice to the general creditors—for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned. To hold otherwise would really be to deny the surety subrogation altogether."

Respondents then argue that, the bank having paid for the bond, for a "presumed purpose" of meeting a contingency of receivership, the bond should be treated as an *asset* of the bank in receivership. This argument, we submit, totally ignores the fact and runs directly counter to law. As to the fact, there seems no need for presuming a purpose. The plain purpose of the bond, so far as the Commonwealth was concerned, was the security of public deposits and, so far as the bank was concerned, was the procurement of the Commonwealth's funds so that the bank might invest them and profit thereby for its own account. As to the law, we submit that any argument which converts

a liability into an asset answers itself. The case of *United States Fidelity Company v. Wooldridge*, 268 U. S. 234, 238, cited by respondents at page 16 of their brief, related to a bond securing the fidelity of the president of the bank. Thus the bank there was *creditor* in the bond, whereas here the bank was principal *debtor* upon the bond. All of which, we submit, supports the reasoning of the District Court (R. 16, 17) that the depositors had nothing to do with this bond and same was not in any wise for their benefit.

Respondents undertake then to mark the depository bond as part of the receivership estate, the trust res for creditors. Could the bank *sue* upon the bond? On the contrary, the bank could have been sued upon it, had petitioner not paid the creditor named in it. And as it was not an asset of the bank, so it cannot be constructed into an asset of the bank's estate after it has been performed If the bank had secured the Commonwealth by pledging its capital assets instead of by suretyship, that collateral would have been the property of the Commonwealth to the extent of the debt, and the partial payment of the debt by the sale of that collateral would have been immaterial to the dividend basis. When the bank escapes the necessity for surrendering its capital assets, by the use of the alternative of suretyship, why should the creditor's realization by suretyship be any more material to the bank's obligation to pay its date-of-insolvency obligation by liquidating dividends on its amount?

Respondents further say, at page 25 of their brief, that they do not owe petitioner $135,000, and, at page 17 thereof, that payment of dividends upon $135,000 would cut into the bank's estate to the prejudice of the other creditors. *Petitioner is not asking payment of $135,000 to itself.*[1] It is asking simply that the estate pay to it *the*

[1] Respondents cite numerous cases holding that the sovereign right to preference in insolvency does not pass to the sovereign's subrogee. No such right is claimed in the present case, and no such question is involved.

exact amount remaining unpaid by the bank on its date-of-insolvency debt of $135,000, namely, $68,588.56, by the medium of dividends on that debt of $135,000. The date-of-insolvency deposit balance, according to the reasoning of this court in *Merrill v. National Bank of Jacksonville,* 173 U. S. 131, 19 S. Ct. 360, 43 L. Ed. 640, must be the only claim on this deposit account cognizable by the receiver to the end of liquidation. Thus, instead of prejudicing other creditors, the use of that basis for dividends represents precisely what all creditors should and must have expected. Therefore, substitution of petitioner to that primary debt by subrogation at once follows out the *Merrill* case principles and avoids, rather than involves, violence to the fixed ratio of all creditors' interests in the estate.[2]

3. As to the Fact That Petitioner Was a Compensated Surety.

Respondents suggest in effect that because petitioner was a compensated surety it ought to the fullest conceivable extent to suffer loss. The cases cited for such a policy of discrimination against paid sureties (Respondents' brief, pp. 21, 22) appear to relate to release of surety obligations by departure from original contract terms. In the instant case no such point is involved, for there is no effort to avoid the suretyship. On the contrary, it has been honored

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[2] The Fourth Circuit Court relied upon the *Merrill* case in holding the surety "*undoubtedly entitled*" to subrogation to the primary debt, in *Fouts v. Maryland Casualty Co., 30 F. (2d) 357.* Respondents, at page 35 of their brief, call this holding dictum because the Court there was denying a different quantum of dividend recovery to the plaintiff surety. But where a Court denies one quantum *because* the *only* right (subrogation to the primary debt) is otherwise, certainly the Court is *deciding* the "only right", and not merely referring to it as dictum. Certainly the lower court in the *Fouts* case would be bound, upon the Circuit Court's opinion in it, to extend to the surety subrogation to the primary debt.

and performed, and the only question is the medium of salvage. All that the surety claims is that that medium should be the date-of-insolvency debt of the debtor, consistently with the *Merrill* case principle fixing the bank's obligations in liquidation exclusively upon the quantum and ratio of debt existing at that date.

If it is true that in some situations the compensated surety is not the favorite of the law, neither, we submit, need he be made its scapegoat. Truly, if it were the policy of the law not only to guard against a paid surety's *release* from obligation, but, even where he has *performed* his obligation, to visit upon him the greater loss because he had before receivership made a small premium profit, even such policy must have been fairly accommodated in the present case. Here the petitioner has already suffered an irrecoverable loss, entirely apart from dividends, in the sum of interest on the deposit after insolvency paid by the petitioner to the Commonwealth (R. 13—$2,150.34). Here also the prospective further loss by failure of future dividends is great, respondent bank having paid to date, by always decreasing dividends, only 75% upon its date-of-insolvency debt.

4. As to the Case of Merrill v. National Bank of Jacksonville, 173 U. S. 131.

Respondents point out, at page 24 of their brief, that the claimant in the *Merrill* case was the secured creditor of the national bank and not, as here, his surety. This has always been clear. Our argument derives from the *Merrill* case not because petitioner pretends to be the secured creditor but because of the reasoning of this Court there seems to us to require the result reached by the District Court here. There the holding was that the secured creditor was entitled to dividends on the full amount of the deposit without deduction of amount realized from collateral held for it. *For what reason?* Because to be "ratable" dividends must be on a uniform rule, applicable to all alike as

at *the same date* . . . the date of the closing of the bank, after which no new debt could be created. *That reasoning, we submit, requires that the account in question here, the $135,000 deposit account of the Commonwealth, be the basis of dividends to the end of liquidation,* whether they be payable to the Commonwealth or a successor to its position by assignment or subrogation. Otherwise, a new debt, in the sum the petitioner *happens* to pay after insolvency, is created in contravention of the principle that rights and proportions are fixed at date of insolvency. That such debt has nothing to do with the debt structure of the bank at date of insolvency seems manifest from the fact that its time and amount are not at all within the control of the bank but can be contrived and managed by the creditor and the surety after insolvency. If in the instant case the petitioner had used every means to keep the Commonwealth in the position of claimant, the Commonwealth concededly would be entitled to the dividends on $135,000 awarded by the District Court to petitioner as its subrogee. Does the *reasoning* of this Court in the *Merrill* case cease to apply to this national bank liquidation, so as to permit a *change* in the quantum and proportion of date-of-insolvency debt, simply because petitioner came forward and *performed a bond which the depositors could not enforce, and performed it at a time and to an amount bearing no relation whatsoever to their previously vested proportions in the bank's estate?*

Respondents suggest, at pages 25 and 26 of their brief, that "there is no res" to which petitioner can be subrogated, the Commonwealth having been made whole. It seems sufficient to answer that the exact reverse is the law. Unless and until the subrogor is made whole, subrogation cannot be had, because to allow it would allow the subrogee to compete with the creditor he has undertaken to secure. The respondents' own quotation, at page 8 of their brief, from the opinion of this Court in *American Surety Co. v. Westinghouse Electric Manufacturing Co. et al.*, 296 U. S. 133, 137, is complete authority upon the principle.

In concluding reply petitioner respectfully urges upon this Court the *omission* marking respondents' brief. In reversing the District Court's award to petitioner of dividends upon $135,000 the Circuit Court below reasoned that the loss of depositors was their deposits and the loss of petitioner was its payment of $68,588.56 upon the depository bond, and that they should share upon the basis of these losses. We have advanced argument, at page 6 of the petition, Reason 3, pages 17 and 18 of the brief annexed to the petition, and page 6 of petitioner's brief, that the Circuit Court's decision is seriously in error even if the dividend basis adopted by it were correct, because its decision left wholly out of account the coefficient essential to ratability, i. e. *percentage of dividend*, and thus would leave petitioner with 35% in dividends in a situation where admittedly the depositors have received 75% on deposits. To our said argument in chief we add the point that respondents have not undertaken to answer any part of it. *If*, therefore, the dividend basis of $68,588.56 adopted by the Circuit Court below were correct, respondents, by their silence, evidently agree with us that *ratability could be achieved with it only by awarding petitioner 75% of that base.*

The consistent, legally certain and true solution, we contend, is that reached in the District Court below, causing the receiver thereby simply to *complete the payment of the bank's $135,000 debt*—no more and no less—by payment of dividends on the sum of that debt until the $68,588.56 portion *yet unpaid by the bank* upon it shall have been paid.

Respectfully submitted,

GEORGE P. WILLIAMS, JR.,
RUTLEDGE SLATTERY,
FRANK P. SLATTERY,
Attorneys for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

BRIEF FOR THE RESPONDENTS.

GEORGE P. BARSE,
(Counsel for Comptroller of the Currency),
Attorney for Respondents.

H. P. MCFADDEN,
Bethlehem, Pennsylvania,
Of Counsel.

LEE ROY STOVER,
HARRIET BUCKINGHAM,
RICHARD BURKE,
(Assistant Counsel for Comptroller of the Currency),
Of Counsel.

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(2)—It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As

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previously indicated, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank 8

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(2)—In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The District Court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of certiorari) the position and reasoning of the District Court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely for-

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

BRIEF FOR THE RESPONDENTS.

I.

THE FACTS.

The facts are not in dispute. The case was decided upon the pleadings, (consisting of the bill of complaint and exhibits thereto attached (R. 2-10), and the motion to dismiss, —R. 10) as supplemented by two stipulations of counsel (R. 11-13; 21-22). The allegations and statements comprised within the pleadings and the stipulations, are summarized in the petition for writ of certiorari (pp. 2-4; 9-10).

However, in view of the fact that the bond securing the deposit of the Commonwealth of Pennsylvania (signed by

the bank as principal, and by petitioner as surety), was dated and became effective as of *December 10, 1928*, whereas the bank was placed in conservatorship on *March 15, 1933*, it was deemed appropriate to remove any doubt that might be entertained,—from the face of the record,—as to whether the bond had been kept continuously in force and effect by the payment by the bank to the surety of the required annual premiums during said period. Hence, by agreement of counsel, a letter was written by counsel for petitioner, dated October 10, 1941, clarifying the record in this respect, with the understanding, as indicated in said letter, that the facts therein stated should be

> "submitted to the Supreme Court of the United States for its consideration to the same extent and effect as if included in the formal transcript of record, and that our agreement in this regard may be evidenced by the insertion of a copy of this letter as an appendix of Respondents' brief which you are about to file."

Accordingly, a true copy of said letter of October 10, 1941, is contained in the appendix hereof at p. 28.

Attention is also directed to an inadvertent but erroneous assumption of fact by the District Court to the effect that the surety bond in question had been "bought and paid for" by the Commonwealth of Pennsylvania (R. 16):

> "On the one hand, if the surety be allowed dividends on the full amount of the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis of his claim, *then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take*—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim." (Italics inserted)

II.

QUESTIONS PRESENTED.

The questions presented are summarized in the following extract from the opinion of the court below: (R. 16)

> "The question before the court on this appeal is the basis upon which the plaintiff surety might prove and receive dividends. Plaintiff takes the position that it is entitled to dividends upon the full amount of its obligee's original bank claim which was $135,000. The court below, after a carefully prepared and thoughtfully reasoned opinion, sustained the plaintiff's view. The receiver contends that plaintiff is entitled to participate in the liquidation of the bank to the extent of a claim of $68,588.56, the amount it actually paid to the Commonwealth. There is also the question of whether the plaintiff is entitled to interest upon further dividends which have been declared and paid to other creditors, but which the plaintiff has not received."

III.

SUMMARY OF ARGUMENT.

A.

THE CLAIM OF A SURETY FOR REIMBURSEMENT MUST BE MEASURED BY THE AMOUNT THE SURETY ACTUALLY PAYS THE PRINCIPAL'S CREDITOR UNDER THE REQUIREMENTS OF THE SURETY'S BOND. THE FACT OF INSOLVENCY OF HIS PRINCIPAL DOES NOT PERMIT ENHANCEMENT OF, OR INCREASE IN, THE FACE AMOUNT OF SAID CLAIM AS PERMITTED TO BE FILED IN THE INSOLVENCY PROCEEDINGS AS A BASIS OF DIVIDEND PAYMENTS THEREON TO THE SURETY FROM THE ESTATE OF HIS PRINCIPAL.

(1) It is settled law that the claim of the surety for reimbursement from the principal, or from the estate of the principal, must be measured by the amount paid by the

surety to the creditor of the principal under the requirements of the surety bond. This is the measure of recovery, irrespective of whether reimbursement is sought upon a claim of indemnity, or under a claim of subrogation.

(2) It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank:

B.

IT WOULD BE INEQUITABLE TO THE GENERAL DEPOSITORS AND CREDITORS OF THE RECEIVERSHIP BANK TO ALLOW THE SURETY COMPANY, BY SUBROGATION OR OTHERWISE, A CLAIM, AS THE BASIS OF DIVIDENDS; IN THE SUM OF $135,000, REPRESENTING THE FULL AMOUNT OF THE DEPOSIT OF THE COMMONWEALTH AT THE TIME OF THE SUSPENSION OR CLOSING OF THE BANK.

(1) The deposit balance to the credit of the Commonwealth on the date of suspension or closing of the bank was more than double the amount permitted by the State statute and hence, to the extent at least of the excess, was illegal.

(2) In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The District Court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of certiorari) the position and reasoning of the District Court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely fortuitous" (R. 17) circumstances, in consequence of the execution of the surety bond—were clearly in error, both in reasoning, and in the assumptions of fact, upon which reliance was made.

C.

THE CASE OF MERRILL v. NATIONAL BANK OF JACKSONVILLE, (1899) 173 U. S. 131, RELIED UPON BY PETITIONER, DOES NOT SUPPORT HIS POSITION, BUT, TO THE EXTENT APPLICABLE TO THE INSTANT CASE, SUPPORTS THE POSITION OF RESPONDENT.

(1) Analysis of the Merrill case:

(2) Comments and observations concerning the Merrill case in so far as it may apply to, or may be distinguished from, the instant case:

IV.

ARGUMENT.

A.

THE CLAIM OF A SURETY FOR REIMBURSEMENT MUST BE MEASURED BY THE AMOUNT THE SURETY ACTUALLY PAYS THE PRINCIPAL'S CREDITOR UNDER THE REQUIREMENTS OF THE SURETY'S BOND. THE FACT OF INSOLVENCY OF HIS PRINCIPAL DOES NOT PERMIT ENHANCEMENT OF, OR INCREASE IN, THE FACE AMOUNT OF SAID CLAIM AS PERMITTED TO BE FILED IN THE INSOLVENCY PROCEEDINGS AS A BASIS OF DIVIDEND PAYMENTS THEREON TO THE SURETY FROM THE ESTATE OF HIS PRINCIPAL.

(1) It is settled law that the claim of the surety for reimbursement from the principal, or from the estate of the principal, must be measured by the amount paid by the surety to the creditor of the principal under the requirements of the surety bond. This is the measure of recovery, irrespective of whether reimbursement is sought upon a claim of indemnity, or under a claim of subrogation.

> "Subrogation gives indemnity only. It cannot take place beyond the amount actually disbursed under legal necessity." (60 C. J. page 724)

To the same effect: (Restatement of the Law—Restitution—sec. 162(c))

> "c. *Where obligation not fully discharged.* Where property of one person is used in partially discharging an obligation owed by another, and the balance of the obligation has not been discharged, the former is not entitled to be subrogated to the position of the obligee. Until the obligation is fully discharged, the obligee is himself entitled to enforce the balance of his claim, and the person whose property has been used in dis-

charging only a part of the claim is not entitled to occupy his position. *If the balance of the claim is subsequently discharged by the obligor, however, the person whose property was used in discharging a part of the obligation is entitled then to be subrogated to the claim to the extent that his property was used in discharging the claim.* (Italics inserted)

"" 'rations:

"1. A owes B $100 and C is surety for A on the debt. C pays B $25 in part payment of the debt. C is not entitled to be subrogated to B's claim against A, although he is entitled to reimbursement from A.

"2. *The facts are as stated in Illustration 1, except that A has paid B the balance of the debt. C is entitled to be subrogated to B's claim against A to the extent of $25.*" (Italics inserted)

Also see: *Memphis & Little Rock Railroad* v. *Dow*, (1887) 120 U. S. 287, 302; *In re Freeman & Brooks* (C. C. A. 7, 1924), 1 F. (2d) 430, 434; *Lacy* v. *Maryland Casualty Co.* (C. C. A. 4, 1929), 32 F. (2d) 48, 53; *Union Indemnity Co.* v. *Stevens* (C. C. A. 5, 1932), 57 F. (2d) 839, 840; *In re Kent Refining Co.* (W. D. Mich., 1937), 20 F. Supp. 661, 662; *In re Metropolitan Motor Car Co.* (Mass. 1924), 299 Fed. 320, 322; *The Livingstone* (C. C. A. 2, 1904) 130 Fed. 746, 749; *Brown* v. *Thompson, et al.*, 128 S. E. 309, 312; 99 W. Va. 56; *Napier* v. *Duff*, (1939) 281 Ky. 779, 136 S. W. (2d) 1083, 1086; *Smith* v. *Wells*, (Ind. 1919) 122 N. E. 334, 338; *Faires* v. *Cockerell*, 31 S. W. 190, 193; 88 Tex. 428; *Phipps* v. *Fuqua* (Tex. Civ. App. 1930), 32 S. W. (2d) 660, 663; *Reserve Loan Life Insurance Co.* v. *Dulin* (Ind. App. Ct. 1919), 122 N. E. 3, 7; *Batsell* v. *Richards* (Tex. 1891), 16 S. W. 313, 314; *Royal Indemnity Co.* v. *White Engineering Corp.*, 120 Misc. 332, 198 N. Y. S. 264, 270; *Krebs* v. *Bezler* (Mo. 1936), 89 S. W. (2d) 935, 937; *Gifford* v. *Rising* (Supreme Ct. N. Y. 1891), 12 N. Y. S. 430; *25 R. C. L.* pg. 1389; *60 C. J.* pg. 724.

As to the functional similarity of operation of the remedies of indemnity and of subrogation:

"A surety who has undertaken to pay the creditors of the principal, though not beyond a stated limit, may

not share in the assets of the principal by reason of such payment until the debts thus partially protected have been satisfied in full. This is the rule where the right to a dividend has its basis in the principle of equitable subrogation. 'A surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied.' *United States* v. *National Surety Co.*, 254 U. S. 73, 76. If the holding were different, the surety would reduce the protection of the bond to the extent of its dividend in the assets of the debtor. *Jenkins* v. *National Surety Co., supra.* The rule is the same, and for like reasons, where the basis of the claim is the debtor's promise to indemnify, if the debtor is insolvent when the promise is enforced. *Jenkins* v. *National Surety Co., supra*, at pp. 266, 267." *American Surety Co.* v. *Westinghouse Electric Manufacturing Co. et al.*, (1935) 296 U. S. 133, 137.

(2) It would seem entirely clear, in principle, that the fact that the principal has become insolvent, and has been placed in liquidation proceedings, does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, supra, page 6, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under the bond.

Any possible doubt in this connection, so far as concerns provable claims against insolvent national banks in receivership, is removed by the provisions of section 5236, Revised Statutes, (Sec. 194, Title 12, U. S. C.), requiring ratable dividends, and by construction of the statute by the courts, to the effect that the claims established thereunder must be in the amount owing to the claimant by the bank as of the date of closing of the bank:

"§ 194. Dividends on adjusted claims; distribution of assets

"From time to time, after full provision has been first made for refunding to the United States any de-

> ficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. § 5236.)"

To the effect that the amount of the provable claim for dividend purposes must be the amount owing to the claimant by the bank as of the date of closing of the bank, see: *Merrill* v. *National Bank of Jacksonville*, (1899) 173 U. S. 131, 146; *White* v. *Knox*, (1884) 111 U. S. 784, 786; *Scott* v. *Armstrong* (1892) 146 U. S. 499, 511; *City of Fort Worth* v. *McCamey* (C. C. A. 5, 1937), 93 F. (2d) 964, 969; *cert. denied* 304 U. S. 571; *Steele* v. *Randall* (C. C. A. 8, 1927), 19 F. (2d) 40, 42; *McDonald* v. *Chemical National Bank* (1899), 174 U. S. 610, 619; *McCandless* v. *Dyar* (S. D. 1928), 34 F. (2d) 989, 991; *Ross* v. *Lee* (S. D. Fla. 1936), 15 F. Supp. 972, 973.

B.

IT WOULD BE INEQUITABLE TO THE GENERAL DEPOSITORS AND CREDITORS OF THE RECEIVERSHIP BANK TO ALLOW THE SURETY COMPANY, BY SUBROGATION OR OTHERWISE, A CLAIM, AS THE BASIS OF DIVIDENDS, IN THE SUM OF $135,000, REPRESENTING THE FULL AMOUNT OF THE DEPOSIT OF THE COMMONWEALTH AT THE TIME OF THE SUSPENSION OR CLOSING OF THE BANK.

It is settled doctrine that subrogation is entirely an equitable right, and it is not inevitably and inflexibly applied or allowed in all cases. A general statement of the law in

this respect is contained in *Sheldon on Subrogation*, (2d Ed.) sec. 4, p. 5:

> "*It is a Mode of Equitable Relief.*—Subrogation is an exercise of the equitable powers of the court, to relieve a meritorious creditor, who might otherwise be subjected to loss by his funds being applied to pay another's debt, or by the operation of proceedings at law against the estate or funds of one who is indebted both to him and to others. This remedy is allowed only when it does not conflict with the legal or equitable rights of other creditors of the common debtor; and the principle is one of equity merely, and will be carried out in the exercise of a proper equitable discretion, with a due regard to the legal and equitable rights of others. One who claims this equity must be governed by the common maxim, *Sic utere tuo ut alienum non laedas.*"

Also see *Aetna Life Insurance Co.* v. *Middleport*, (1888) 124 U. S. 534, 549, 550.

For the reasons hereinafter indicated, it is considered, that under the facts and circumstances existing in the instant case, the surety should not be allowed a claim against the receivership, for dividend purposes, in excess of the sum of $68,588.56, representing the amount paid by the surety to the Commonwealth, under the terms of the bond. (R. 4, 6)

It may well be, in view of the restrictions contained in the State statutes relating to State deposits, hereinafter next discussed, that the surety should not be allowed a claim in excess of $62,500, inasmuch as that sum is the maximum amount that could be legally deposited under a bond of $125,000.00

(1) The deposit balance to the credit of the Commonwealth on the date of suspension or closing of the bank was more than double the amount permitted by the State statute and hence, to the extent at least of the excess, was illegal.

The Pennsylvania statutes, hereinafter next quoted, prohibit the deposit of state funds in a sum greater than

one-half of the amount of the bond required to be furnished by the depository. The amount of petitioner's bond in the instant case was $125,000.00 (R. 3). The amount of the deposit to the credit of the Commonwealth at suspension of the bank was $135,000.00 (R. 3). Therefore the maximum amount legally permitted to be on deposit under the security of the $125,000.00 bond, was $62,500.00, thereby resulting in an illegal excess of $72,500.00. The controlling state statutes in this connection provide:

Sec. 3812, Title 72, Purdon's (1936) Pa. Stats.

> "The state treasurer before making such deposits shall require each bank, banking institution or trust company to give a good and sufficient bond, containing a warrant of attorney to confess judgment in favor of the commonwealth in double the amount of the contemplated deposit, with sureties to be approved by the board of revenue commissioners of the commonwealth of Pennsylvania, and no deposit shall at any time be greater than one-half of the amount of the bond furnished by said depository. And, further, the said bond or bonds so given shall include a special obligation to settle with and pay to the state treasurer, for the use of the commonwealth, the amount of interest as it shall become due, semi-annually (1897, June 15, P. L. 157, Sec. 2.)"

Sec. 3791, Title 72, Purdon's (1936) Pa. Stats.

> "All banks, banking institutions, and trust companies, selected as aforesaid, shall, upon the receipt of notice of such selection as depositories of State moneys, furnish a bond to secure payment of deposits and interest to the Commonwealth of Pennsylvania, with a proper warrant of attorney to confess judgment in favor of the Commonwealth, secured by a surety company or individual sureties, to be approved by the Revenue Commissioners and Banking Commissioner, or a majority of them, in double the amount of the deposit to be made, and, if corporate bonds are given, no one company shall be approved in an aggregate amount in excess of five times its capital, surplus and reserve. (1906, Feb. 17, P. L. 45, Sec. 5.)"

(a) It is settled doctrine that public funds deposited in a bank contrary to the requirements of statutes regulating such deposits, constitute illegal deposits. See: *Fiman* v. *State of So. Dak.* (C. C. A. 8th, 1928) 29 F. (2d) 776, 778, *cert.* denied 279 U. S. 841; *U. S. N. B. of Centralia* v. *City of Centralia,* (C. C. A. 9th, 1917) 240 Fed. 93, 95; *cert.* denied 243 U. S. 656; *Merchants National Bank* v. *School District,* (C. C. A. 9th, 1899) 94 Fed. 705, 706; *Board of Commissioners* v. *Strawn,* (C. C. A. 6th, 1907) 157 Fed. 49, 50; *Montgomery* v. *Ward*--(Ala., 1933) 151 So. 583, 585; *Poweshiek County* v. *Merchants Nat. Bk.,* (Iowa, 1928) 220 N. W. 63, 66.

(b) A claimant seeking subrogation must act fairly and equitably and be free from fault in the transaction in connection with which he claims subrogation. He will not be entitled to subrogation where he derives his claim through or from a wrongdoer.

To the foregoing effect see: *Galliland* v. *Williams,* 181 Ala. 173, 61 So. 291, 293; *Boyer* v. *Bolender,* 129 Pa. 324, 18 Atl. 127, 128; *Bates* v. *Swiger,* 40 W. Va. 420, 21 S. E. 874, 878; *Montgomery* v. *Ward, supra; Eshleman* v. *Bolenius,* 144 Pa. 269, 22 Atl. 758, 759; *Troyer* v. *Bank of Dequeen,* (Ark. 1926) 281 S. W. 14, 16; *German Savings and Loan Society* v. *Tull,* (C. C. A., 9th, 1905) 136 Fed. 1, 6.

Also see "Additional Cases", App. p. 31.

As above indicated, *supra,* p. 10, the deposit balance to the credit of the Commonwealth at the time of suspension and closing of the bank, and for which claim was allowed to the Commonwealth by the receiver in the sum of $135,000 represented moneys illegally deposited by the State Treasurer to the extent of $72,500, said sum constituting the excess over the permitted one-half of the depository bond. Had the deposits been restricted to the permitted amount of $62,500, as enjoined by State statute, the assets of the receivership would not have been required to respond for said excess of $72,500. While it is by no means suggested that petitioner participated in, or in any way was causally

responsible for, the making of said illegal deposits, nevertheless, the claim of the petitioner to subrogation in the base amount of $135,000, is necessarily derived from, and is a result of, the making of said illegal deposits by the State treasurer, in that the proof of claim in that amount allowed by the receiver to the Commonwealth embraces said sum of $72,500.

Consequently, in the light of the doctrines established by the hereinabove cited cases, (*supra*, p. 12) it would seem clear that it would be inequitable and in contravention of the vested rights of the general depositors and creditors of the receivership bank, to allow petitioner the right of subrogation for any sum in excess of the sum of $62,500, representing the maximum amount permitted to be deposited, and constituting the maximum face amount for which a claim should be allowed.

(c) Subrogation should not be allowed where the claim sought to be charged and enforced against innocent third parties—resulted from, or was caused by, the negligence of the claimant.

To the foregoing effect see: *Ft. Dodge Building & Loan Association* v. *Scott*, (Iowa, 1892) 53 N. W. 283, 284; *Coonrod* v. *Kelly*, (C. C. A. 3rd 1902) 119 Fed. 841, 848; *Porter* v. *Ourada*, (Nebr. 1897) 71 N. W. 52, 53; 60 C. J., par. 21, pp. 708-709.

It would seem clear that petitioner, as surety upon the depository bond, was chargeable with notice as to the requirements of the State depository statutes including the definite restriction upon the amount which could lawfully be deposited. Petitioner was chargeable with notice that recovery could not be had, through subrogation, as to amounts illegally deposited in excess of the permitted maximum under the bond, and it would therefore seem necessarily to follow that petitioner was guilty of negligence in not supervising the deposit account to the extent of being kept constantly informed as to the balance thereof, and that said balance was within the allowed maximum.

There can be no doubt that the books of the bank reflecting the deposit entries were at all times open to appropriate inquiry on the part of petitioner as to the condition and status of the deposit so far as amount was concerned.

Assuming and conceding that petitioner, as surety, was an innocent party in the transaction, it is obvious that the depositors and other creditors of the bank were likewise innocent parties, and had no connection whatsoever with the transaction in question. The equities, therefore, would clearly seem to be with the depositors and other creditors under the recognized maxim that where loss is sustained, affecting two innocent parties, the one whose negligence or other wrongful act made the loss possible should suffer the loss. See: page 848 of *Coonrod* v. *Kelly, supra;* and 60 C. J., p. 707.

(2) In balancing the equities, the general depositors and creditors of the receivership bank are entitled to have the benefits of the surety bond, rather than to have it weighed in the balance against them. The district court, (R. 16-17) and also petitioner, in adopting (page 15 of his petition for writ of ceriorari) the position and reasoning of the district court—to the effect that the general depositors and creditors of the bank would be receiving a "windfall" by reason of "purely fortuitous" (R. 17) circumstances, in consequence of the execution of the surety bond—were clearly in error, both in reasoning, and in the assumptions of fact, upon which reliance was made.

The district court, in stating the problem involved, and in the course of indicating the basis of its decision against the respondents, stated, in the opinion:

> "The creditor, having been paid, and so eliminated as a factor in the problem, it remains to balance the surety's rights and the interests of the general creditors. It is not easy to arrive at any solution which is entirely satisfactory and leaves one free from doubt as to the justice of the result. On the one hand, if the surety be allowed dividends on the full amount of

the creditor's claim, they will be based upon an amount in excess of what he has expended, whereas the general creditors will be sharing only on the basis of their actual advancements. If, on the other hand, the surety is limited to the amount which he has actually paid as the basis of his claim, *then the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take*—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim.

"On the whole, it seems to me that, if the real objective of the doctrine of subrogation be kept in mind, we come closer to distributing the loss fairly and avoiding unjust enrichment of any interest by allowing the surety to claim on the basis of the full amount of the creditor's claim. By so doing it may be possible to reimburse him fully, and still do entire justice to the general creditors—*for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned.*" (Italics inserted)

As pointed out in the supplementary statement of facts herein (*supra*, p. 2) the district court erroneously assumed that the surety bond had been "bought and paid for" by the Commonwealth of Pennsylvania, the statement of the court in that connection being (as set forth in the foregoing quotation) that

"the general creditors get a windfall, for no other reason than that one of them has bought and paid for additional protection which none of the others chose to take—for, of course, if there had been no suretyship, the creditor would be proving and receiving dividends on the full amount of his claim." (R. 16)

The fact is, however, as pointed out in the supplementary statement of facts herein (*supra* p. 2) the surety bond was "bought and paid for", *not* by the Commonwealth of

Pennsylvania, *but by the bank, in 1928*, and the bank paid the annual premiums upon said bond to petitioner, for a period of approximately five years prior to the appointment of the conservator for the bank in March of 1933. (See letter of October 10, 1941, appendix hereof p. 28).

Still laboring under this mistake of fact, and placing substantial reliance upon the fact thus erroneously assumed, the trial court reasoned and concluded:

> "for it can hardly be called unjust or unfair to leave them exactly where they would have been had there been no suretyship, with their rights neither impaired nor enlarged by an arrangement with which they had nothing to do and which was purely fortuitous so far as they are concerned."

The reasoning thus indulged, and the conclusion thus reached, appears substantially inequitable to the general depositors and creditors of the bank. The surety bond was procured and paid for by the bank with the presumed intent and expectancy that it would become operative in performance and payment of the penalty therein provided, only in the event of insolvency of the bank. There being no question as to the fact that the bank would be obligated to repay the deposits thereunder to the commonwealth from time to time, as demanded, there could be no other reason and no other occasion or contingency, upon which payment of the penalty under the bond would be required.

The surety bond must be considered, and relied upon, as an asset of the bank in receivership. As stated by this court in *United States Fidelity Company* v. *Wooldridge*, (1925) 268 U. S. 234, 238, in considering a fidelity bond relied upon and collected by the receiver of a national bank:

> "the right of the Railway Company was simply that of a depositor, a right to share with other unsecured creditors in the assets of the Bank, of which the bond now in suit was a part."

The surety bond involved in the instant case was for the benefit of, not only the Commonwealth of Pennsylvania as a public depositor, but it was also, indirectly, for the benefit of the general depositors and creditors of the receivership bank, in that the amount of the penalty required to be paid by the surety under the bond to the commonwealth enabled and permitted the other assets of the bank on hand at the time of suspension and closing,—and constituting a trust *res*,—to be applied toward the payment of the general depositors and creditors.

It thus follows, in consequence, that the general depositors and creditors are entitled to retain the full benefit of the assets constituting this trust *res*. *It further follows that the general creditors and depositors are not thereby fortuitously obtaining a "windfall", and that they are only realizing upon a potential asset bought and paid for by the bank prior to suspension and for the presumed purpose of meeting exactly the contingency, to wit, receivership, which did occur.*

If petitioner should be allowed, either by way of subrogation or of implied indemnity,—to participate by way of dividends upon the basis of a claim of $135,000, instead of upon a claim measured by the amount expended under the penalty of the bond, ($68,588.56) the petitioner would thereby substantially cut into the assets constituting the trust *res* retained for the benefit of the general depositors and creditors,—entirely contrary to, and beyond the measure permitted by, the surety bond. As well stated by the court below in its opinion,

> "*The risk that the debtor bank might become insolvent was the very thing which the surety company insured against and presumably was paid for so doing. That was the same risk which was taken by the unsecured depositors in the bank who, along with the surety, now seek an apportioned share of the bank's assets.* There is only so much money to go around; the more one gets the less someone else will receive. The surety and the depositors shared the same risk. It seems fair

> that they should share, in partial compensation for their loss, on the same basis. The basis on which the depositors share is the proportion of their actual loss, the amount of their deposits. The surety's actual loss is the same that it paid out, which was $68,588.56. This, we think, is the basis on which it is entitled to claim." (Italics inserted) (R. 30)

The State statutes under which the deposits in the instant case were made, and in pursuance of which the bond was given, will be found in the appendix hereof at p. 29.

It will be noted from the foregoing quotation from the opinion of the court below, that the court considered that the relation between the Commonwealth and the surety was in the nature of that of insured and insurer. The same conclusion has been reached by the Pennsylvania courts. In *Commonwealth* v. *U. S. F. & G. Co.*, (Pa. 1934) 170 Atl. 686, 688, the court said:

> "* * * Read in the light of the statutory regulation and of the object to be attained, the words used were obviously intended to insure payment, and, therefore, solvency of the bank —or, in other words, that the bank would always be in condition to pay. Though termed 'surety', defendant is an insurer. South Phila. State Bank v. National Surety Co., 288 Pa. 300, 305, 135 A. 748, and cases cited; also see the General Insurance Act of 1921 (P. L. 682, secs. 661 to 665 [40 PS secs. 832-836]). The purpose was to provide insurance of state deposits. * * * Liability was not intended to depend on the commonwealth's right to sue the bank; it was intended, inter alia, to cover a receivership. South Phila. State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123; National Surety Co. v. Franklin Trust Company (Pa. Sup.) 170 A. 683. Any other construction would attribute to the parties an intention to express their agreement in words that would satisfy the statute, when, in fact, they intended to disregard it, an interpretation that cannot be tolerated. * * *"

In *Young* v. *American Bonding Co.* (1910) 228 Pa. 373, 77 Atl. 623, 625, the court said:

"* * * In all essential particulars the appellee here is an insurance company, and its obligation in this particular instance was that of an insurer. It was paid for its undertaking; the amount of its compensation being based on the calculation of risk assumed. * * *"

In the case of *In Re South Philadelphia State Bank's Insolvency*, (1929), 295 Pa. 433, 145 Atl. 520, the court was considering the respective equities of a surety claiming subrogation under a depository bond, and the general depositors and creditors of the bank. The particular point with which the court was concerned in its discussion hereinafter next quoted, was the right of the surety to be subrogated to the preferred status of the Commonwealth growing out of its sovereign priority rights; and the conclusion was there reached that such priority rights intended for the benefit and protection of the sovereign, should not, in equity and good conscience, be exercised by the surety, by subrogation, to the prejudice and detriment of the general depositors and creditors of the receivership bank. The court said (p. 521):

"Though the state of Pennsylvania has a sovereign right of priority over all other creditors, it by no means follows that, on the facts in this case, such right would pass to one in the position of appellant. It must be remembered that appellant, a surety obtained and paid by the insolvent bank, not by the commonwealth, claims the right to enjoy the sovereign privileges of the latter, and this under the equitable doctrine of subrogation; the right claimed is to a preference over all other depositors of the bank. Since the right of priority of the sovereign state exists *pro bono populo*, it follows that, where a situation arises in which the state, having been paid in full, is not immediately concerned, and where the transfer of its right of priority would result in prejudice to one class of its citizens for the benefit of another, it cannot be held that the good of all the people would thus be served. It may well be assumed that the ordinary depositor in a bank which enjoys state deposits, knowing that, in event of the insolvency of the institution, the state has the right to

priority of payment, would likewise know that the laws of Pennsylvania require all state deposits to be secured by bonds with ample security thereon. Furthermore, since the doctrine of subrogation is an equitable one, the ordinary depositor might properly believe that, in event of the insolvency of their depository, if no necessity existed for the state to protect itself by exercising its sovereign right to priority of payment, that right would not be used to his prejudice, and, on such basis, he would make, or continue, his deposits; therefore the doctrine in question should not be allowed to operate in a manner to produce prejudicial results to such depositors.

• • •

"We conclude that appellant surety company has the equitable right to stand in the shoes of the commonwealth as a depositor, but not to enjoy its right of priority over other depositors. When the bank failed, the commonwealth had all the rights of an ordinary depositor; those rights passed by subrogation to appellant. The commonwealth had also the sovereign's right to priority of payment over other depositors, but, owing to the peculiar nature of that right, it would not pass by subrogation to appellant."

By way of analagous application to the instant case, of the discussion contained in the foregoing quotation, it may be observed:

(a) That although the surety company was there allowed subrogation to the rights of the Commonwealth as a depositor, such allowance was based upon the fact that the surety had paid the full amount of the deposit of the Commonwealth in the receivership bank.

(b) Adopting, (but not quoting) and paraphrasing to the extent considered appropriate, portions of the language contained in the foregoing quotation, it seems fair to state, by analogous application that:

It may well be assumed that the ordinary depositors in a national bank in Pennsylvania which enjoys State deposits, knowing that, in the event of the insolvency of the bank, the State would enjoy, in effect, a pre-

> ferred status in view of the fact that the laws of Pennsylvania require all State deposits to be secured by bonds with ample security thereon, and further, since the doctrine of subrogation is an equitable one, the ordinary depositors might properly believe that in event of insolvency of their bank, the State would be paid by the surety under the penalty of its bond (*and that such bond would be in double the amount of the State's deposit, as required by law*) and that through application of the doctrines of subrogation, the surety might acquire such rights, remedies or securities as the State possessed for the protection and enforcement of its depository rights, and that under such circumstances the depositors could safely continue their deposits in the bank, and that, in view of such circumstances, and upon the assumption that all requirements of the State depository law had been made, *the ordinary depositors could well assume further that such rights of subrogation as the surety might acquire through payment of the deposit of the State, would not be used to their prejudice nor to detract from nor diminish the vested rights which they had in the assets possessed by the bank at the time of its failure and suspension, constituting a trust res required by law to be administered for the benefit of the depositors and creditors of the bank.*

It is only fair, of course, that the fact that petitioner is a corporate surety should not be used as a basis of undue discrimination, nor to deprive it of any rights to which it is lawfully entitled, whether by way of subrogation or otherwise. However, it is proper, in weighing the equities, to have in mind the situation indicated by the Pennsylvania Supreme Court in *Young* v. *American Bonding Company*, (1910) 228 Pa. 373, 77 Atl. 623, 626, wherein the court said:

> "• • • The trend of all our modern decisions, federal and state, is to distinguish between individual and corporate suretyship where the latter is an undertaking for money consideration by a company chartered for the conduct of such business. In the one case the rule of *strictissimi juris* prevails, as it always has. With respect to the other, because it is essentially an insur-

> ance against risk, underwritten for a money consideration by a corporation adopting such business for its own profit, the courts generally hold that such a company can be relieved from its obligation for suretyship only where a departure from the contract is shown to be a material variance. * * *"

The above extract was quoted with approval in *Sokoloff* v. *Fidelity and Casualty Co.*, (1927) 288 Pa. 211, 135 Atl. 746; *In re Harr*, (Pa. S. Ct., 1935) 179 Atl. 725; and *Penn R. Co.* v. *Fidelity & Deposit Co.*, (C. C. A. 3d, 1936) 81 F. (2d) 526, 528. See also footnote 4, (R. 30) of the opinion of court below (116 F. (2d) 77), citing 12 A. L. R. 382 and 94 A. L. R. 876.

C.

THE CASE OF MERRILL v. NATIONAL BANK OF JACKSONVILLE, (1899) 173 U. S. 131, RELIED UPON BY PETITIONER, DOES NOT SUPPORT ITS POSITION, BUT, TO THE EXTENT APPLICABLE TO THE INSTANT CASE, SUPPORTS THE POSITION OF RESPONDENT.

Petitioner relies also upon *Merrill* v. *National Bank of Jacksonville, supra,* to support its position. Analysis of the case would seem to indicate that it does not support petitioner's contentions, but that, to the extent that the *Merrill* case is applicable, it supports the contentions of respondent.

(1) Analysis of the Merrill case:

The First National Bank of Palatka, Florida, was in receivership. The National Bank of Jacksonville, Florida, held a claim against the First National Bank, for approximately $10,000.00, secured by certain collateral, and sought to prove its claim against the First National Bank in the face amount of approximately $10,000.00 (the amount of the indebtedness at the time of suspension of the First National Bank) and to retain said collateral for future liquidation and application, as permitted by law. The National Bank

of Jacksonville contended that it was entitled to receive dividends from time to time upon said face amount of said claim without surrendering to the receiver said collateral. The receiver, by direction of the Comptroller of the Currency, refused to allow the claim, for dividend purposes, in the face amount of approximately $10,000, and insisted (p. 132) that said creditor must, first "exhaust the collaterals given to secure the certificate of deposit, and then * * * prove for the balance due, after applying the proceeds of the collaterals in part payment". The issue thus raised, was, in due course, presented to this Court for determination, on appeal. This Court held:

(a) The assets of the insolvent bank constituted a trust *res* for the benefit of all of its creditors, and a creditor, upon proof of claim, acquired a vested interest in the trust *res.* (pp. 136, 138).

(b) "The distribution is to be 'ratable' on t[illegible]ms as proved or adjudicated, that is, on on[illegible]e of proportion applicable to all alike. In or[illegible] to be 'ratable' the claims must manifestly be estimated as of the same point of time, and that date has been adjudged to be the date of the declaration of insolvency. *White* v. *Knox*, 111 U. S. 784." (p. 143.)

(c) In quoting from *White* v. *Knox*, 111 U. S. 784, this Court said, in the *Merrill* case, (at p. 144 thereof):

"Mr. Chief Justice Waite, speaking for the court, said: 'Dividends are to be paid to all creditors, ratably, that is to say, proportionally. To be proportionate they must be made by some uniform rule. They are to be paid on all claims against the bank previously proved and adjudicated. All creditors are to be treated alike. The claim against the bank, therefore, must necessarily be made the basis of the apportionment * * * The business of the bank must stop when insolvency is declared. Rev. Stat. sec. 5228. No new debt can be made after that. The only claims the Comptroller can recognize in the settlement of the affairs of the bank are those which are shown by proof satisfactory to him or by the adjudication of a competent court to have had their origin in something done before the insolvency. It is

clearly his duty, therefore, in paying dividends, to take the value of the claim at that time as the basis of distribution'." (p. 144)

"In short, the secured creditor is not to be cut off from his right in the common fund because he has taken security which his co-creditors have not. Of course, he cannot go beyond payment, and surplus assets or so much of his dividends as are unnecessary to pay him must be applied to the benefit of the other creditors. And while the unsecured creditors are entitled to be substituted as far as possible to the rights of secured creditors, the latter are entitled to retain their securities until the indebtedness due them is extinguished." (p. 141)

• • •

"Our conclusion is that the claims of creditors are to be determined as of the date of the declaration of insolvency, irrespective of the question whether particular creditors have security or not. When secured creditors have received payment in full, their right to dividends, and their right to retain their securities cease, but collections therefrom are not otherwise material. Insolvency gives unsecured creditors no greater rights than they had before, though through redemption or subrogation or the realization of a surplus they may be benefited." (p. 147)

(2) Comments and observations concerning the Merrill case in so far as it may apply to, or may be distinguished from, the instant case:

(a) As indicated by the court below (R. 28), the Merrill case "did not concern a surety and, therefore, is not directly in point here." The instant case concerns "the rights of a surety who has paid a part of a claim against a national bank which is in liquidation", and the extent to which the surety may be entitled to subrogation, if at all, by reason of having paid a portion of the claim of the creditor protected by the bond. Such questions were not involved in the Merrill case.

(b) In the Merrill case the secured creditor's claim against the bank was measured by the amount of its de-

posit balance as of the date of suspension of the bank. As previously indicated herein (*supra*, p. 6), the claim of the petitioner, as surety, should be measured by its claim against the bank as represented by the amount paid by petitioner to the creditor to the extent required under the bond. The bank does not owe petitioner the amount it originally owed the secured creditor ($135,000); it owes the petitioner only the amount lawfully expended under the requirements of the bond.

(c) In the Merrill case the court held, in effect, that when dividends paid by the receiver, plus proceeds of liquidation of collateral, equalled the amount of the creditor's claim, said claim would be discharged. The result under such circumstances would be that the remaining assets of the receivership would be retained for distribution to the general depositors and creditors.

In the instant case no unliquidated collateral remained in the hands of the Commonwealth, and consequently, there was no basis of subrogation in that respect.

So far as subrogation to rights and remedies are concerned, the situation is obviously different from what it would have been if the secured creditor had held, as collateral, a note or other obligation owing to the bank by a third party, in which event it may be assumed, for discussion, that petitioner would have succeeded, by subrogation, to the rights and remedy of the Commonwealth, as a creditor, to pursue the collateral claim against the third party for the purpose of applying it upon the bank's indebtedness to the Commonwealth. However, in the instant case, the claim of the Commonwealth was against the bank, and the claim of petitioner is against the bank. Therefore, it would appear, in substance, that there is no *res* or *corpus*, either by way of collateral or remedy to which petitioner can be subrogated. Further, if full weight be given to the established principle in the Merrill case that the claim of the secured creditor is extinguished when fully paid by dividends and realization upon collateral, it would seem to

follow that there remained no claim, on the part of the Commonwealth, to which petitioner could be subrogated.

(d) The formal assignment executed by the Commonwealth to petitioner would appear to have no bearing upon the issues here involved. Obviously, under equitable doctrines, substance rather than form must be considered, and petitioner cannot, through the form of an assignment, enhance or increase his claim against the insolvent bank to the detriment and prejudice of the general depositors and creditors. See: *Withers* v. *D'Auria Bank & Trust Co.* (1937), 122 N. J. Eq. 503, 195 Atl. 298; *Meyers* v. *Bank of America Nat. Trust & Savings Ass'n., et al.* (1938), 77 Pac. (2d) 1084, 1086.

As stated by the court below:

> "As a possible makeweight it can be added that the surety in this case took an assignment from the creditor, after the surety had paid the sum due the creditor. This makeweight, however, has no added force since, at the time of the assignment, the claim had been discharged. We do not think that the assignment added anything to the rights which the surety already had. See Louisville Trust Co. v. Royal Indemnity Co., 230 Ky. 482, 20 S. W. (2d) 71 (1929)." (R. 29)

Our examination of the authorities indicates that the issues involved in the instant case have not heretofore been passed upon by this court. Counsel for petitioner appear to have reached the same conclusion. However the decision of the court below is in accord with decisions in the closely analogous cases of: *Maryland Casualty Company* v. *Cox*, (C. C. A. 6, 1939) 104 F. (2d) 354; *U. S. F. & G. Co.* v. *Hood*, (1934) 206 N. C. 639, 175 S. E. 135; *Ward* v. *First Nat. Bank of Caruthersville*, (C. C. A. 8, 1935) 76 F. (2d) 256; *In re Kent Refining Co.*, (W. D. Mich., 1937) 20 F. Supp. 661.

Additional comments on cases cited by Petitioner will be found in Appendix at p. 35.

V.

CONCLUSION.

The judgment of the court below should be affirmed.

Respectfully submitted,

GEORGE P. BARSE,
(Counsel for Comptroller of the Currency),
Attorney for Respondents.

H. P. MCFADDEN,
Bethlehem, Pennsylvania,
Of Counsel.

LEE ROY STOVER,
HARRIET BUCKINGHAM,
F. RICHARD BURKE,
(Assistant Counsel for Comptroller of the Currency),
Of Counsel.

VI.

APPENDIX.

Law Offices of

JOSEPH A. SLATTERY

123 South Broad Street

Philadelphia

October 10, 1941.

George P. Barse, Esq., General Counsel,
Office of Comptroller of the Currency,
Room 309, Treasury Building,
Washington, D. C.

Dear Sir:

You have asked us to clarify the record in the matter of American Surety Company of New York v. Bethlehem National Bank et al., now pending in the Supreme Court of the United States, on the point whether the petitioner surety company was a paid surety. Confirming our conversation on the telephone today, we are writing to advise that petitioner in this case was a paid surety. The respondent Bank paid to it an annual bond premium to maintain in effect the bond of December 10, 1928, and the bond was in effect and the Commonwealth's deposit was secured thereby at the time of the appointment of the conservator on March 15, 1933, as averred in Paragraph 6 of the complaint (R. 3).

It is agreed between us that the foregoing facts may be submitted to the Supreme Court of the United States for its consideration to the same extent and effect as if included in the formal transcript of record, and that our agreement in this regard may be evidenced by the insertion of a copy of this letter as an appendix of Respondents' brief which you are about to file.

Yours very truly,
(Signed) RUTLEDGE SLATTERY.

RS/hs

Excerpt from Section 1102 of Act No. 274, approved June 7, A. D. 1923, known as the Administrative Code, as amended by Act No. 164, approved April 13, A. D. 1927.

Section 1102. Board of Finance and Revenue. * * * the Board of Finance and Revenue shall have the power and its duty shall be:

(c) To select and designate as depositories for the State moneys, banks, banking institutions or trust companies, which are subject to national or State supervision and each of which

1. Has made written application to the State Treasurer for a deposit of State moneys designating the amount of deposit solicited and accompanying its application by a written statement showing the amount of its capital actually paid in, the amount of its surplus, the number of its stockholders, and whether its stock is well distributed or largely held by a few individuals, and the length of time that said institution has been engaged in business under its charter. Each such statement shall be verified by the oath or affirmation of the president, cashier or trust officer as the case may be, and the State Treasurer shall present the same to the Board for its consideration within thirty days after the receipt thereof, provided, that where the selection of any bank, banking institution or trust company as a depository of State moneys has been made by the former Revenue Commissioners and the Banking Commissioner, or a majority of them as heretofore provided by law such selection and the deposit made in accordance therewith in such bank, banking institution or trust company shall in no way be affected by the failure of such bank, banking institution or trust company to have made application in the manner herein provided but it shall be the duty of the depository so selected to furnish on request the information aforesaid verified in the manner stated.

2. Shall upon the receipt of notice of its selection as a depository of State moneys furnish a bond to secure payment of deposits and interest to the Commonwealth of Pennsylvania with a proper warrant of attorney to confess judgment in favor of the Commonwealth secured by a surety company or individual sureties to be approved by the board in the amount of the deposit to be made. If a corporate bond be given no one surety company shall be approved in an aggregate amount in excess of five times its capital, sur-

plus and reserve. Provided, that in lieu of the surety bonds of surety companies or of individuals as aforesaid the deposit of State moneys may be secured by the deposit with the State Treasurer, of United States, municipal or county bonds to be approved by the board in an amount measured by their actual market value equal to the amount of deposit so secured and twenty per centum in addition thereto. Said bonds shall be accompanied by proper assignment or Power of Attorney to transfer the same and said trust deposit of securities shall be maintained on request at the amount aforesaid in case of any depreciation in the value thereof.

3. Agree to pay interest upon all State deposits at the rate of not less than two per centum per annum upon active deposits and not less than three per centum per annum upon non-active deposits, and that all collections shall be made for the Commonwealth without cost or compensation.

• • • •

(f) To see that no bank, banking institution or trust company shall receive a deposit of State moneys in excess of twenty-five per centum of its paid-in capital and surplus, or have at any one time an aggregate of deposits in excess of five hundred thousand dollars. This section shall not apply to institutions to be designated by the board as active depositories of State funds subject to daily check by the State Treasurer, but at no time shall the combined deposits in the active depositories exceed the total sum of ten million dollars.

ADDITIONAL CASES ON SUBROGATION.

Old National Bank v. *Swearing*, 72 S. W. (2d) 545, 548 & 549; 167 Tenn. 529

FACTS: Life tenant under will borrowed money to pay taxes and improve property. Gave bank a note secured by mortgage. It was claimed that life tenant did not have the power under the will to mortgage property and bank contended that if the mortgage was not valid they should be subrogated to the claims of the lienors whose demands were discharged.

HELD: As to the lien for repairs, there was no subrogation as said lien had expired prior to the payment by the bank.

As to the lien for taxes, the bank could not be subrogated as search of title would have disclosed that in a prior proceeding it was determined that the life tenant did not have the power to incumber property, so the bank was guilty of such culpable negligence as to preclude any favor at the hands of the Court of Equity.

Morrah v. *First National Bank*, 65 S. W. (2d) 830, 831 (1932)

QUESTION: Right of bank to become subrogated to first mortgage lien which was discharged and paid by bank upon faith of release of note secured by second mortgage holder who, in fact, had sold note prior to release.

Second mortgage holder attempted to have said mortgage declared a first and prior lien.

HELD: Bank not guilty of culpable negligence, but if so would not have been entitled to subrogation which was granted in this case. Also, no showing that the right of the second mortgage holder was prejudiced and thus subrogation was not denied.

Wallace v. *Benner*, (1931) 156 S. E. 795, 799

"The exceptions to the general rule to the doctrine of subrogation: (1) The relief is not granted to a volunteer; (2) nor where the party claiming relief is guilty of culpable negligence; (3) nor where to grant relief will operate to the prejudice of the junior lienholder."

However, the facts in this case did not come in any of the above exceptions, and the subrogation was granted.

Huey v. *Brand*, (1936) 92 S. W. (2d) 505, 507

FACTS: The tax collector illegally deposited funds in the bank and the president of the bank and another executed a surety bond. Upon failure of the bank, Huey paid the state and was allowed a general claim against the bank.

The present action is for the purpose of establishing a preferred claim on the theory that Huey was entitled to the right of subrogation to the preferential right of the sovereignty, which was denied.

"The rule of preferential right of sovereignty to be paid ahead of its citizens comes from monarchial Europe. It is held to be transferred therefrom into the law of democratic America by the legislative adoption of the English common law. It was a prerogative that belonged to ancient kings, before justice for the common man was born. If it may be justified as a cold legal formula, now a part of American jurisprudence, we doubt that either its origin, or the result of its application to the average bank failure, is such as to produce enthusiasm or profound respect in the modern judicial mind of this country. This much is said to show that courts should recognize its binding force in any form only in a clear case. Concerning it the Supreme Court of Pennsylvania has held: 'The proper rule is that the state's right to a preference over other creditors, being a sovereign right enjoyed for the benefit of all the people, cannot be transferred to individuals except by express legislative sanction.' In re South

Philadelphia State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123, at page 1125. However, we need not announce such as the Texas rule Upon equitable principles more hoary with age than Anglo Saxon jurisprudence, Huey is not entitled to the right of subrogation, conceding the preferential right of sovereignty, and that same may be transferred to an individual. We quote some of these:

'Subrogation does not owe its origin to statute or custom, nor is it a doctrine of the common law. It originated in equity and is a creature of equity, a doctrine of equity jurisprudence which was adopted by equity from the Roman or the civil law. * * *

'Subrogation is founded upon principles of justice and equity and rests upon the principle that substantial justice should be attained regardless of form. Its basis is the doing of complete, essential and perfect justice between all the parties without regard to form. * * *

'It will not be enforced unless there is some equitable doctrine upon which it can be predicated, and only when the applicant therefor has an equity to invoke and his cause is just and its enforcement is consonant with right and justice, and then only in a clear case. It will not be allowed where it would be contrary to public policy, or where it would accomplish by indirection that which a statute forbids to be done by direction. * * *

'Nor can the doctrine be extended so as to authorize the application of the principle for the relief and benefit of a party who voluntarily surrenders a right or suffers an injury, the consequence of his own willful neglect or wrong, or who has connived at and assisted in the wrong, for one seeking subrogation must come into court with clean hands. * * *

'The person seeking subrogation must act fairly and equitably and be free from fault. It will not be allowed where he has intermeddled with the rights of others, or is guilty of fraud or culpable negligence, or where he would derive an advantage from, or establish his claim through, his own negligence, or, in any way, would thereby reap advantage from his own wrongdoing. * * *

'Subrogation will be granted only where an equitable result will be reached. It will not be allowed when to do so would be inequitable or where it would accomplish injustice.' 60 C. J. pp. 696, 697, 698, 699, 701, 702, 707, 708 and 709.

"See, also, Padgett v. Young County (Tex. Civ. App.) 204 S. W. 1046; 60 C. J. p. 729.

"In this case Huey openly flaunted the law of the state and violated his oath of office by depositing state funds illegally. A. P. Borger conspired with him in this high-handed act. Now both are before a court of equity, claiming in effect a right of preference over the individual depositors of the Borger State Bank, based upon their own wrongdoing. Who would pay Huey if his claim be allowed? Obviously the general depositors would contribute. Laborers, bended with toil, gingham-clad washer women, the aged, the infirm, even the orphan—these a part of the usual run of bank depositors are to be made to enlarge the bank account of Huey and enrich the estate of A. P. Borger. This consequence is claimed to flow directly from a violation of Huey's official duty in making an illegal deposit with Borger's bank. We confess little enthusiasm or respect for the rule which gives the state the legal right to take the assets of an insolvent bank from the above class, and none at all for the rule invoked by both Huey and Borger's estate in this case. That it would work a loss and grave injustice to the general depositors of the Borger State Bank is, to our mind, as clear as sunlight. Such a contention was rejected by the Pennsylvania Supreme Court upon the same reasoning we use here. In re South Philadelphia State Bank's Insolvency, 295 Pa. 433, 145 A. 520, 83 A. L. R. 1123.

"The judgment of the trial court allowing the Huey claim as a preference is hereby reversed and rendered in favor of the Banking Commissioner."

ADDITIONAL COMMENTS ON CASES CITED BY PETITIONER.

Fouts v. *Maryland Casualty Co.* (C. C. A. 4th, 1939) 30 F. (2d) 357.

The opinion discloses at pg. 359 that the surety company was asking for the allowance of an indemnity claim and payment of bank dividends thereon before the State Treasurer had received all the dividends due on the state's claim, the court stating:

> "It is shown by the record that Mr. Lacy has not yet received all his dividends, in fact there is a considerable sum in the receiver's hands to be distributed, yet the court permits the proving and filing of the casualty company's claim for a certain fixed amount necessarily greater than the company's final loss."

The above statement indicates that expressions in the last paragraph of the opinion of the court with respect to the surety's right of subrogation cannot be determinative of the question involved in the instant case and must be considered as dicta.

American Surety Co. v. *De Carle,* (C. C. A. 9th, 1928) 25 F. (2d) 18.

In this case the full amount of the depository bond was paid by the surety and left unpaid a substantial amount of the County Treasurer's deposit in the bank. However, the surety, basing its claim against the receiver on its indemnity agreement, sought allowance of a claim for dividend purposes before the Treasurer was paid in full. The court denied the surety's claim based on the indemnity agreement and indicated the surety's only right would be that of subrogation after the claim of the County Treasurer was satisfied. Clearly, the court's statements with respect to subrogation, though relied upon by the petitioner, were merely *dicta* in this case.

City of Oakland v. *Hartford Accident & Indemnity Co.,* (C. C. A. 6th, 1936) 81 F. (2d) 717.

The City sued the surety to enforce payment upon a depository bond covering funds deposited in a state bank by the City. Upon suspension of the bank, the City in a prior

suit in the state courts was denied a claim for dividend purposes for the full amount of the City's deposit, the state court requiring a deduction of the proceeds of pledged bonds in determining the amount of the City's claim for dividend purposes. This case in the Federal court was a suit by the City against the surety company only, to recover the deficiency after applying the proceeds of the collateral and a dividend. The court held judgment should have been rendered against the surety for the difference between its liability on the bond nd that portion of the deposit for which the City had been compensated by application of the dividend payment and the collateral proceeds. As the surety had never paid its obligation on the bond, no questions of subrogation were before the court for consideration. As to that portion of the court's opinion holding the City was entitled to receive a dividend upon the full amount of the claim without deducting the value of the collateral, it will be noted that this point was *res adjudicata*, in view of the previous decision by the state court to the contrary.

In re Thompson (W. D. Pa. 1924), 300 Fed. 215.

A brief statement of the facts in the above entitled case will show that the holding of the court is not applicable to the facts of the instant case. In that case the holder of fifteen promissory notes compelled an indorser to pay the entire indebtedness. The indorser then assigned his claim for value to the Federal Security Company, which proved the claim against a co-indorser's bankrupt estate. Two other co-indorsers were insolvent. Held: That the Company was entitled to dividends on the entire claim as proved, for as a surety it was subrogated to the rights of the principal debtor.

It will be noted that the *entire debt* was paid by the surety; that the surety's claim was filed against a *bankrupt* estate; and there was not involved a question of the construction of the ratable distribution provisions of the National Bank Act. The case involved the rights of an individual surety, as distinguished from a corporate surety. The Pennsylvania courts in a long line of decisions have held that the rule of *strictissimi juris* in favor of an individual surety does not apply to a contract of suretyship by a corporation, underwritten for a money consideration for profit. *Young* v. *American Bonding Co.*, (1910) 228 Pa. 373, 77 Atl. 623; *Shaw* v. *New Amsterdam Cas. Co.*, (1933)

310 Pa. 213, 164 Atl. 916; *Dairymen's Co-operative Sales Co.* v. *Maryland Cas. Co.*, (1934) 11 F. Supp. 423, aff. C. C. A. 78 F. (2) 1014; *Justice* v. *Empire State Surety Co.*, (Pa. 1913) 209 Fed. 105, aff. 218 F. 802.

Lidderdale's Executors v. *Executor of Robinson*, (1827) 25 U. S. 594.

The question involved was whether a joint endorser of a bill of exchange who had paid more than his share was entitled to priority of payment under the Virginia law against the estate of a co-endorser. The Virginia act provided that protested bills of exchange had equal dignity with a judgment after the death of the drawer or endorser and the executors or administrators shall suffer judgment to pass against them for all debts due upon a protested bill of exchange before payment of other debts of inferior dignity. The court granted priority to the endorser in the amount by which his payments had exceeded his share of the debt. The case does not appear to involve a problem of subrogation of a surety to rights of a creditor in the distribution of assets of an insolvent national bank under a ratable distribution statute, as no statutory priority of payment against an insolvent national bank is possible under the decisions of this court. *Cook County National Bank* v. *U. S.*, (1882) 107 U. S. 445; *Davis* v. *Elmira Savings Bank*, (1896) 161 U. S. 275; *Old Company's Lehigh* v. *Meeker*, (1935) 294 U. S. 227; *Jennings* v. *U. S. F. & G. Co.*, (1935) 294 U. S. 216.

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IN THE

Supreme Court of the United States

October Term, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

BRIEF OF RESPONDENTS IN REPLY TO BRIEF OF UNITED STATES FIDELITY & GUARANTY COMPANY, AS AMICUS CURIAE.

GEORGE P. BARSE,
(Counsel for Comptroller of the Currency),
Attorney for Respondents.

H. P. McFADDEN,
Bethlehem, Pennsylvania,
Of Counsel.

LEE ROY STOVER,
HARRIET BUCKINGHAM,
F. RICHARD BURKE,
(Assistant Counsel for Comptroller of the Currency),
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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BRIEF OF RESPONDENTS IN REPLY TO BRIEF OF UNITED STATES FIDELITY & GUARANTY COMPANY, AS AMICUS CURIAE.

By leave of Court first had and obtained, Respondents submit their reply to the brief of United States Fidelity and Guaranty Company filed in the above entitled cause as *amicus curiae*.

For convenience of designation, the company will be referred to as the "Fidelity Company".

The Fidelity Company's brief is designed to support the position of American Surety Company of New York, Petitioner, and hence Respondents' reply will be governed accordingly.

A.

Reply to the Fidelity Company's Point (3), pages 9-13, that "No Equity Exists on the Part of the Other Creditors of the Bank that Would Prevent the Full Application of the Doctrine of Subrogation."

The opinions of both courts below expressly indicated that their respective decisions were based upon the assumption that Petitioner's cause of action was founded upon the doctrine of subrogation. Apparently in recognition of this, the position of the Fidelity Company is summarized by the following extracts from its brief on page 9:

> "By operation of the doctrine of subrogation, the rights and remedies which a creditor has against the debtor to allow him to recover the debt vest in a surety paying such debt. This is done to thereafter enable the surety to make recovery from the debtor whose primary responsibility it is that such debt be paid."
>
> * * * *
>
> "The doctrine, of course, is equitable in its nature and because of that fact, will not be applied where an inequitable result would be obtained. It is used to further a fairness of treatment among all parties concerned and any court, in applying it, must look to see that no innocent person's rights are prejudiced thereby. If, in this case, the other depositors of the bank could show that the application of this doctrine resulted in their being treated unfairly, then, of necessity, any court would refuse to fully apply it. However, such is not the case."

The second portion of the above quoted extracts (with the exception of the last sentence thereof) summarizes, likewise, the position of Respondents with reference to the inherent equities necessary to be considered in applying the doctrine of subrogation. Respondents submit that the equities of the "other depositors of the bank" will not be served by Petitioner's application of the doctrine of subrogation in the instant case, for the following reasons:

(1) The deposit balance of $135,000 owing to the State of Pennsylvania by the bank at the date of suspension and closing, was paid off in the sum of approximately $67,000 derived from dividends from the Receiver on March 27, 1934, plus liquidation of the pledged collateral on or about April 23, 1934. (R. 4) Consequently by April 23, 1934, the debt of the bank to the State had been paid, to that extent and *pro tanto* discharged, leaving a balance due to the State as of April 23, 1934, of approximately $68,000.

Petitioner paid this balance to the State, under the requirements of its bond as surety, in three installments, the last of which was made on April 28, 1934. (R. 4.)

(2) It would seem necessarily to follow, therefore, so far as substance is concerned, that inasmuch as the bank's debt to the State had been *pro tanto* discharged by the application of the assets of the bank in the approximate sum of $67,000, Petitioner could not equitably acquire, either by subrogation or assignment, that portion of the deposit which had already been discharged by the bank, and that Petitioner, as surety, could not acquire any interest in the debt greater than the remaining unpaid portion of $68,000. Petitioner concedes in its bill of complaint that the payments thus made on behalf of the bank in approximately the sum of $67,000, plus the payment by Petitioner, under its bond, of approximately $68,000—

> "fully satisfied and discharged the claim of said Commonwealth of Pennsylvania on account of the balance standing to its credit on deposit in said The Bethlehem National Bank of Bethlehem, Pennsylvania, on March 15, 1933 and amounting to the sum of One Hundred Thirty-five Thousand Dollars (135,000.00) as aforesaid." (R. 4)

(3) It is settled doctrine that claims against a national bank in receivership can only be for the amount owing by the bank to the claimant at suspension and that dividends are to be paid upon the basis of the claim thus established.

However, such claim is subject to subsequent apportionment.

The payment by petitioner of the sum of approximately $68,000.00 as required by the depositary bond, resulted, by operation of law, in the apportionment to and acquisition by, Petitioner, of a claim against the bank for $68,000.000.

It seems perfectly clear that it would be inequitable, and would constitute an injustice to the other depositors of the bank to allow Petitioner a claim on the sum of $135,000, inasmuch as the bank had already discharged $67,000 of that claim. The allowance of a claim of $135,000 would constitute unjust enrichment of Petitioner, at the expense of the other depositors.

(4) The real relation of Petitioner's claim to the bank may be further exemplified by the following contrasts and suppositions:

Assume, by way of contrast, that shortly before suspension and closing, the cash and liquid assets of Bethlehem National Bank had been depleted by heavy cash withdrawals and that its remaining assets were substantially "frozen" so that it was unable, upon demand of the State, to pay the entire $135,000 deposit balance; assume further that prior to suspension, the bank paid to the State approximately $67,000 of its deposit balance, and that petitioner, under the requirements of its existing depositary bond, paid the State the remaining balance due of approximately $68,000, and that shortly after these payments had been made, the bank had suspended operations and closed, without the surety having been reimbursed by the bank. Petitioner's claim against the bank prior to suspension and closing would, of course, amount to approximately $68,000. It is obvious that the closing of the bank and the appointment of a receiver would not result in any enhancement or appreciation of the claim of the surety, and that the surety could only establish a claim against the bank in receivership in said sum of approximately $68,000.

It seems clear, therefore, that the basic principles are not changed by the fact that the *pro tanto* discharge of the deposit liability by the bank by the application of $67,000.00 of its assets, and the payment of $68,000.00 by Petitioner,—was made after suspension of the bank.

(5) The question of whether the surety shall have, on the one hand, subrogation to the entire amount of the creditor's claim, or, on the other hand, as to whether the surety shall have only partial subrogation, must be measured, in this respect, by the amount paid by the surety under the requirements of its depositary bond. If the surety pays the entire amount of the creditor's claim, the surety is entitled to subrogation to that extent. If the surety pays only part of the creditor's claim, the surety is entitled only to subrogation to a corresponding portion of the creditor's claim.

The respective equities of the surety, and of the general depositors, were considered and balanced, and the balance decided in favor of the general depositors, in the case of *Ward* v. *First National Bank of Caruthersville, et al.*, 76 F. (2d) 256. In that case the amount of the deposit at suspension was approximately $26,000, and the surety, under its bond, expended approximately $4,800 of its own money toward payment of the deposit, the balance of the deposit being paid from the proceeds of collateral belonging to the bank. The surety sought subrogation to the entire amount of the $26,000 deposit. The Circuit Court of Appeals for the Eighth Circuit held that the surety was not entitled to assert a claim for the full amount of the deposit, inasmuch as he had paid only part of the deposit, and accordingly the surety was allowed a claim of approximately $4,800. The surety sought to apply, by analogy, the doctrines in *Merrill* v. *National Bank*, 173 U. S. 131. The court's decision was based, not only upon the conclusion that the *Merrill* case did not apply, even by analogy, but further that the equities preponderated in favor of the general depositors. The fol-

lowing extracts from the opinion of the court are pertinent, particularly in relation to the equities of the case (pp. 257, 258):

> "The only claim the plaintiff had against the bank was for the sum of $4,827.20. This is the total sum plaintiff now seeks. Yet, because plaintiff handed over to the county the proceeds of the collateral which he held by reason of his being a surety, he now seeks to receive dividends on the collateral turned over until the dividends equal the sum of $4,827.20. Such a course of action would inevitably result in paying to the plaintiff a greater percentage on his claim of $4,827.20 than other creditors would receive on their claims. This is stripping the debtor bank of its property, which is a trust fund for its creditors. We think it is not allowable."

* * * * * * * * *

> "(2) Plaintiff became a creditor of the bank by subrogation to the rights of the county when he had paid to the county out of his own funds, in partial liquidation of the bank's debt, the amount he was obligated to pay as a surety on the bond. The amount was $4,827.20. To that extent plaintiff became an unsecured creditor of the bank by subrogation. Any payment that plaintiff made to the county above that sum he paid from funds (county warrants) belonging to the bank and not from funds of his own. The county warrants so used were being held for the benefit of the county as a secured creditor of the bank. Jenkins v. National Surety Co., 277 U. S. 258, 267, 48 S. Ct. 445, 72 L. Ed. 874."

> "(3) Subrogation is purely an equitable right. It will not be enforced where it would be inequitable to do so, or where it would work injustice to others having equal equities."

Attention is also invited to the case of *Maryland Casualty Company* v. *Cox*, 104 F. (2d) 354, which, in essence, involved the same issues presented in the instant case, so far as concerned the amount of the claim which the surety was entitled to assert against the receivership bank for dividend purposes. The surety had only paid part of the

deposit and the court held that it was entitled to subrogation only for the amount which it paid. (See comments of court below (R. 31).)

(6) On page 10, the Fidelity Company suggests that by giving a depositary bond the bank was enabled to retain assets of $125,000 "which it otherwise would have been forced to pledge with the Commonwealth" and consequently that "recovery under that surety bond should be considered precisely the same as recovery from other collateral pledged by the bank".

The equities of the other creditors of the bank, and the extent to which the surety may be entitled to establish a claim against the bank for the purpose of sharing in the general assets constituting a trust *res* for all of the creditors,—cannot, either logically or equitably, be determined by the comparison of situations involving basically dissimilar factors. The bank had the right to employ either of the two methods. If the bank had pledged collateral for the entire amount required, no questions as to the right of the surety could have arisen. On the other hand, the fact that the bank gave a depositary bond, and was thereby enabled to retain a corresponding amount of assets, establishes no causal relation or factor affecting the subrogation rights of the surety. Those rights are determined by, and are dependent upon, the liabilities assumed and the funds expended by the surety under the requirements of its bond, and the surety's rights are not in any way affected by the fact that the bank retained assets which otherwise it would have pledged. The assets belonged to the bank, and not to the surety. The bank paid the surety for approximately five years for assuming the risk under the bond that the bank might fail and that the surety might be called upon to perform its obligation. As pointed out in Respondents' brief (p. 18) the court below took the position, which seems amply supported by the authorities, that the surety was in effect and substance, an insurer.

If, as the Fidelity Company suggests on page 10 of its brief, the surety bond is to be considered as stand-

ing in lieu of an equal amount of collateral, and recovery under the surety bond "should be considered precisely the same as recovery from other collateral pledged by the bank," it would necessarily follow under the doctrines of *Merrill* v. *National Bank of Jacksonville* (1899), 173 U. S. 131, that upon the payment of the State's deposit from the two sources of pledged collateral and dividend payments, the deposit of the State must be considered discharged, and the general assets on hand at the time of the closing of the bank cannot be subjected to further dividends upon the claim.

(7) On pages 12 and 13 of its brief, the Fidelity Company suggests that if the position of respondents were to be upheld, "it would make for the most varying and fortuitous results in the payment of any such surety, as the amount recoverable by a surety would then depend upon the whims of the other parties to the transaction rather than upon such surety's inherent right of reimbursement." Even if sound, the assumed consequences of "varying" results in the repayment of the surety, would not seem to be a material factor. However the exact opposite is true. The surety knows, at the time the bank fails, exactly what its obligation is under its bond. Its duty is to pay the penalty of its bond immediately, inasmuch as the suspension of the bank is tantamount to failure of the bank to meet its obligation on the deposit. The surety can and should immediately pay the amount required of it and therefore the surety has within its own power the determination of, not only the amount it will pay, but also the corresponding amount of the claim against the bank accruing to the surety from such payment.

On page 13 of its brief the Fidelity Company cites *In re Thompson*, 300 Fed. 215, not only in support of its contention that "varying and fortuitous results in the repayment" of the surety would be avoided by adopting petitioner's contentions, but the Fidelity Company also cites said case for the proposition that a surety is entitled to be subrogated to "the creditor's full claim." It may be noted that

in the *Thompson* case the surety paid the entire amount of the creditor's claim, and, therefore, it may be assumed, for discussion, that the paying surety was entitled to subrogation to the full amount of the creditor's claim thus paid. It may be noted further, however, that the case dealt with relations existing between co-sureties, and that there is considerable conflict as to whether under the circumstances in the *Thompson* case, the paying surety was entitled to full subrogation inasmuch as, in substance, the surety could be credited, so far as the co-surety was concerned, with paying only half of the creditor's claim, for the reason that the paying surety was itself obligated to pay one-half of the claim. The Federal Citator does not indicate that the *Thompson* case has been cited or relied upon in subsequent cases. A strongly persuasive view to the contrary, holding that the paying surety is not entitled to prove a claim against the insolvent co-surety's estate for more than half of the primary creditor's claim is indicated in *New Bedford Institution for Savings* v. *Hathaway*, (1883) 134 Mass. 69, 75. In the *New Bedford* case (where the facts and circumstances were closely analogous to the situation in the *Thompson* case) the Massachusetts court said:

> "* * * Because the creditor might have proved and received a dividend upon the whole debt, this affords no reason why the paying surety should. To the creditor the co-surety had promised he would pay the whole debt, but as between the sureties each was a debtor only to the amount of his proportion. To allow a co-surety to exaggerate this claim would do injustice to other creditors of the insolvent surety. It would be using the fiction of the law that the debt is still unpaid,—which is adopted in equity to protect the paying surety by keeping the debt alive in order that securities may be realized for his benefit,—so that unfair advantage would thereby be taken of other creditors of the insolvent. * * *"

B.

Reply to Certain Other Points in the Fidelity Company's Brief.

(1) On page 6 of its brief the Fidelity Company contends that the original depositary indebtedness in the instant case has not been affected or changed, and that:

> "It stands as it did as of the date of insolvency, and there is no portion of it that has been subtracted from the whole to stand alone. The bank's obligation is unaltered, a new ultimate beneficiary of its performance being the only change."

The Fidelity Company further states on page 7 of its brief:

> "When an attempt is made to alter the amount of the original claim after it has been proven, as was the case here, then to the extent of the alteration it will fail to get its ratable share of the dividends. It cannot be contended that the original claim has been satisfied in part and has survived in part, and at the same time, contend that the original claim is continuing to be ratably treated."

The fact is, however, as previously herein pointed out, that the original deposit of $135,000 was *pro tanto* paid off and discharged to the extent of approximately $67,000 by dividends from the receiver and by application of the proceeds of liquidation of collateral belonging to the bank. It would do violence to the equities to ignore that *pro tanto* discharge of the debt, and to confer the benefit of that discharge upon petitioner.

No general formula such as the statement on page 4 of the Fidelity Company's brief to the effect that the amount of any claim against an insolvent national bank is fixed, for dividend purposes, as of the date of the closing of the bank,—can be permitted to override actualities, or to defeat equities. Any such general rules must be qualified by the situation resulting when a surety voluntarily assumes the obligations of its depositary bond. It is presumed to con-

tract with reference to the law, and to abide by the incidents and consequences legally resulting from its contract. It is presumed to know that:

(a) If it pays only part of the primary debt, it is only entitled, in equity, to acquire the portion of that debt corresponding to the amount it paid.

(b) If it pays only part of the claim of the primary debt, its right to assert its claim for dividend purposes will, by reason of the legal incidents relating to suretyship, be deferred until the primary creditor has been paid in full, at which time the surety can start to receive dividends upon a claim measured by the amount it has expended in part payment of the debt. See *Jenkins, Receiver* v. *National Surety Company*, 277 U. S. 258, 263, and *United States* v. *National Surety Company*, 254 U. S. 73, 76.

(c) If its dividends have been deferred by reason of the circumstances indicated in sub-paragraphs (a) and (b) above, and if thereafter, in due course, the general creditors of the bank have been paid in full, leaving the surety's claim partially unpaid by reason of the beginning of its dividends having been deferred,—it then follows, under equitable doctrines, that the surety will be permitted to continue to receive dividends upon its claim from the surplus assets on hand after the general creditors have thus been paid, the result being that the surety will ultimately be paid the full amount of its claim, notwithstanding the deferment of the beginning of its dividends—assuming, of course, that the surplus assets thus remaining are sufficient to pay the residue of the surety's claim. The surety assumes that risk.

(2) On page 14 the Fidelity Company cites and relies upon *Fouts* v. *Maryland Casualty Company*, 30 F. (2d) 357. That case is not authority for the contentions of petitioner that it is entitled to a claim for the entire amount of the deposit. The Fouts decision reported in 30 F. (2d) 357,

is a continuation of, and is circumscribed by, the issues and limitations involved in the preceding cases of *Maryland Casualty Co.* v. *Fouts,* 11 F. (2d) 71, and *Maryland Casualty Co.* v. *Fouts,* 27 F. (2d) 423. The case in 11 F. (2d) was filed by the Casualty Company to establish a claim against a national bank receivership for the sum of $50,000 paid by it in partial satisfaction of a deposit liability of approximately $89,000. The surety was not claiming subrogation to, or allowance of, a claim of $89,000. The allowance of the claim of $50,000 sought in 11 F. (2d) was denied, for the time being, because, under settled doctrines, the primary debt of $89,000 had not been paid and the court would not permit the surety to compete with the primary creditor by way of dividends while the primary creditor was still unpaid. The case in 27 F. (2d) again sought allowance of a claim of $50,000, and the court allowed the claim upon the supposition that the primary creditor had been paid. The third case, in 30 F. (2d), was an appeal from the case in 27 F. (2d). The Circuit Court of Appeals for the Fourth Circuit reversed the decision of the District Court in 27 F. (2d) on the ground, *inter alia,* that as a matter of fact the primary creditor was still unpaid.

In view of the fact that the surety sought a claim for only the amount it paid, rather than the full amount of the depositor's claim, it is obvious that the last paragraph of the *Fouts* case found on page 359 of 30 F. (2d), and partially quoted on page 14 of the Fidelity Company's brief, to

the effect that the surety was entitled to allowance of the claim for the full amount of the primary debt, could be, at most, only *dictum*. However, an examination of that paragraph apparently does not support the construction drawn from it by the Fidelity Company.

Respectfully submitted,

GEORGE P. BARSE,

(Counsel for Comptroller of the Currency),

Attorney for Respondents.

H. P. MCFADDEN,
Bethlehem, Pennsylvania,

Of Counsel.

LEE ROY STOVER,
HARRIET BUCKINGHAM,
F. RICHARD BURKE,

(Assistant Counsel for
Comptroller of the Currency),

Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK, *Petitioner*,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, Receiver, The Bethlehem National Bank of Bethlehem, Pennsylvania, *Respondents*.

MEMORANDUM INDICATING ADMINISTRATIVE PRACTICE AND POLICY OF THE COMPTROLLER OF THE CURRENCY CONCERNING ALLOWANCE OF CLAIMS OF SURETIES INCIDENT TO LIQUIDATION OF NATIONAL BANKS IN RECEIVERSHIP.

GEORGE P. BARSE,
(Counsel for Comptroller of the Currency),
Attorney for Respondents.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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MEMORANDUM INDICATING ADMINISTRATIVE PRACTICE AND POLICY OF THE COMPTROLLER OF THE CURRENCY CONCERNING ALLOWANCE OF CLAIMS OF SURETIES INCIDENT TO LIQUIDATION OF NATIONAL BANKS IN RECEIVERSHIP.

In compliance with the request of the Court,—made during the course of argument of the above entitled case on November 12, 1941,—an examination has been made of the records of the Office of the Comptroller of the Currency to ascertain the administrative practice and policy of the Comptroller concerning the allowance of claims of sureties, incident to liquidation of national banks in receivership,

where the payment made by a surety under the penalty of a depositary bond constituted only part payment of the deposit to secure which such bond had been given. The result of that examination follows:

1. There are no standing written or printed instructions to receivers by the Comptroller of the Currency concerning the course to be followed in such cases. The Annual Reports of the Comptroller to Congress contain no data relating thereto. The printed instructions do direct that where there is doubt as to the proof, or where legal questions are raised, concerning *any* type of claim, the matter should be submitted to the Comptroller of the Currency for proper instructions. Consequently, it has been necessary to resort to the files wherein instructions in such cases have been given by the Comptroller to the Receivers.

The office files are not arranged or segregated, and no index or classification of the files has been maintained, concerning the type of cases now under consideration. Hence it has not been possible, in the limited time available, to make an exhaustive examination. However it is considered that sufficient official data has been found to indicate definitely the policy and practice of the Comptroller.

The appendix hereof contains true copies of office letters relating to instructions by the Comptroller to receivers, together with pertinent documents concerning such cases, and preceded in each instance by necessary explanatory remarks. These letters and documents cover, approximately, the past eleven years (February 4, 1930 to February 21, 1941). There is no reason to believe that the policy and practice followed prior to February 4, 1930 differed in any respect from that of the past eleven years, and inquiry among the employees of the office indicates that these letters and documents in fact exemplify the standing policy and practice theretofore followed.

2. The letters and documents in question definitely indicate that it has uniformly been the position of the Comptroller that where the payment made by a surety under the penalty of a depositary bond constituted only part payment

of the deposit to secure which such bond had been given, the surety will not be allowed a claim for the entire amount of such deposit as it existed at the date of suspension or closing of the bank, and that the amount of the claim to be allowed the surety will be measured by, and restricted to, the amount thus paid by the surety.[1]

3. Inasmuch as it comprises part of the official data covering the eleven year period, there is also included in the Appendix (pp. 36-43) correspondence between the Comptroller and the receiver in the instant case. It will be noted therefrom that the position taken by the Comptroller is strictly in accord with the policy and practice hereinabove indicated, and that the letter of the receiver of December 23, 1935 (R. 8) was written without previous instructions from the Comptroller, and further, that said correspondence indicates that the offer of August 30, 1939, made by the receiver to the surety (R. 6) was not authorized under the previous instructions of the Comptroller to the receiver. Counsel for petitioner has today (November 13, 1941), by telephone, authorized the following statement to be inserted by the undersigned as counsel for respondent:

> "With reference to the admitted allegation in paragraph 14 of the Bill of Complaint (R. 6) concerning the offer of Receiver Nieman of August 30, 1939, I am advised by counsel for petitioner that this offer was orally made by the receiver during the course of a conference on that date attended by the receiver, by counsel for petitioner and by local counsel for the receiver."

Respectfully submitted,

GEORGE P. BARSE,
(Counsel for Comptroller of the Currency),
Attorney for Respondents.

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[1] It may be of interest to recall previous instances where this Court has noticed and considered administrative practices of the Comptroller. (*Inland Waterways Corp.* v. *Young* (1940), 309 U. S. 517, 524; *Corsicana National Bank* v. *Johnson* (1919), 251 U. S. 68, 83; *Rawlings* v. *Ray* (1941), 312 U. S. 96, 99. Also see: *Lewis, Receiver* v. *Fidelity & Deposit Co.* (1934), 292 U. S. 559, 563, 570 (footnote)).

APPENDIX.

The following letters and documents, covering the period February 4, 1930 to and including February 21, 1941, are grouped with reference to the particular bank involved, and each group is numbered, for convenience of reference.

Explanatory remarks, at the beginning of each group, are then immediately followed by the related letters and documents.

I.

Office letter of February 4, 1930 instructed the receiver of the First National Bank of Clarksville, Arkansas, to allow claims to certain surety companies (who were sureties on depository bonds given as security for deposits of the State of Arkansas) in amounts paid by them in the respective sums of $10,000 and $15,000, the whole amount of the State's deposits totalling $50,000. Litigation ensued and the decision of the United States Circuit Court of Appeals for the Eighth Circuit appears to affirm the position taken in the above mentioned office letter. *State of Arkansas* v. *Pufahl* (C. C. A. 8th, 1931) 52 F. (2d) 116.

February 4, 1930

Mr. M. J. Pufahl, Receiver,
First National Bank
Clarksville, Arkansas.

Dear Sir:

Your letter of January 28th has been received in further reference to Liability #1605 representing a deposit balance in the amount of $50,058.60 due the Treasurer of the State of Arkansas, including interest to the date of suspension at the rate of 3 per cent. This deposit is secured by $25,000 in Fourth 4¼ per cent Liberty Loan bonds, $10,000 surety bond executed by the Aetna Casualty & Surety Company and a $15,000 bond executed by the United States Fidelity & Guaranty Company.

In your letter dated January 11th you requested instructions as to the procedure which should be followed in con-

nection with the Treasurer's claim and such instructions were contained in office letter dated January 20th. You now advise that the situation with regard to the claim of the State Treasurer is somewhat unusual in that the Treasurer holds three separate and distinct contracts, one with the bank covering $25,000 of his account with a collateral agreement; one executed by the Aetna Casualty & Surety Company for $10,000 and one of $15,000 executed by the United States Fidelity & Guaranty Company. You have forwarded with your letter copies of these three contracts and in view of the existance of these contracts it is your opinion that the Treasurer is only entitled to retain a sufficient amount of the proceeds of the Liberty bonds held to cover $25,000 of his account, plus interest accrued on such amount to date of suspension and that the balance of the proceeds should be paid to the trust. It is further your opinion that the bonding companies are not entitled to benefit by reason of the Liberty bonds held and that they are entitled to receive dividends only on $25,000 of the account rather than the full amount thereof. You ask that the office give consideration to the additional information furnished and that further instructions be then rendered you.

In view of the additional information furnished as contained in your letter and in the three copies of the contracts above referred to, the office concurrs in your opinion that the Treasurer is only entitled to retain from the proceeds of sale of the Liberty Bonds, $25,000 plus interest on this amount to date of suspension, at the rate of 3 per cent and the balance of such proceeds should be paid to the trust. On the other hand the bonding companies are only entitled to subrogation to the extent of the amounts paid by them, which we understand will be approximately $10,000 and $15,000, plus the amount of interest accrued to the date of suspension.

You will therefore require the Treasurer to pay to the trust the excess amount recovered from the Liberty bonds and when payment to the Treasurer has been made by the Bonding Companies you will advise as to the exact amounts paid by each and you will then be instructed with regard to the issuance of Receiver's Certificates to the Treasurer for assignment by him to the two companies.

Yours very truly,

(Signed) A. B. MERRITT,
Assistant Supervising Receiver
Div. of Insolvent National Banks.

II.

The Receiver of the First National Bank of Caruthersville, Missouri, was instructed by office letter of May 22, 1931 to allow general claims to the corporate sureties and the personal sureties who had paid in part the bank's obligation to the County in the amounts actually paid by such sureties. Suit was commenced by one of the sureties and the decision of the District Court of the United States In and For the Eastern Division of the Eastern Judicial District of Missouri was handed down on November 24, 1933. As the opinion of the District Court is not reported, copy of the opinion is also inserted. This decision allowed the surety a claim as a general creditor only for the amount he actually paid in discharge of his obligation as surety. The decision was affirmed by the Circuit Court of Appeals, Eighth Circuit, in 1935 in the case of *Ward* v. *First National Bank of Caruthersville*, 76 F. (2d) 256.

May 22, 1931.

Mr. Ralph E. Bailey, Receiver,
First National Bank,
Caruthersville, Missouri.

Dear Sir:

Receipt is acknowledged of your letter of May 4th referring further to the deposit of Pemiscot County totaling $56,356.38 at suspension secured by three corporate surety bonds in the sum of $10,000 each and a personal surety bond in the amount of $35,000 given by the former officers of the bank, the bank having pledged with such former officers County warrants of the total value of $21,002.77. Your bank's obligation to the County was reduced as of suspension by offsetting County warrants totaling $8460.74 contained in the bank's assets The County has now been paid in full, each of the corporate sureties contributing $7368.56. The personal sureties paid the County the total sum of $25,789.96 which included the sum of $21,002.77 obtained for the County warrants by sale in the open market. You discuss the possible secured creditor status of the personal sureties and request instructions concerning the adjustment of claims based on these transactions.

It is a well settled requirement of equity that the surety who holds security of an insolvent debtor must give the benefit of it to the creditor for whom he is surety until the debt is fully paid. Jenkins, Receiver v. National Surety Company, 277 U. S. 258-267. An application of this principle to the facts here presented results in the conclusion that the personal sureties had the duty to deliver the County warrants totaling $21,002.77 to the County to be applied in reduction of the County deposit balance by way of offset. It then became the duty of all the sureties, none of whom held security, to reimburse the County for the full amount of its deposit balance. This has been done by contributions of $7368.56 by each of the corporate sureties and $4787.19 by the personal sureties. On this basis all sureties are entitled to general claims only for the amounts contributed to the County, the County Treasurer under direction of the County Court having assigned his claim against your trust apportioned according to the contributions made by each surety. Accordingly you are authorized to allow each of the three corporate sureties general claims in the amount of $7368.56 and the personal sureties collectively a general claim only in the amount of $4787.19, thus closing the matter.

Yours very truly,

J. E. Fouts,
Supervising Receiver,
Div. of Insolvent National Banks.

DISTRICT COURT OF THE UNITED STATES
in and for the
EASTERN DIVISION OF THE JUDICIAL DISTRICT
OF MISSOURI.

(Copy)

No. 9941.

R. L. WARD, *Plaintiff*,
v.
FIRST NATIONAL BANK OF CARUTHERSVILLE, AND
R. E. BAILEY, AS RECEIVER, ETC., *Defendants*.

FARIS, J.

MEMORANDUM OF ORAL OPINION OF THE COURT.

Plaintiff, a surety on a bond to secure to Pemiscot County, Missouri, a deposit of county money in the First National Bank of Caruthersville, Missouri, sues the bank, now in the hands of a receiver, and the receiver thereof, for an allowance in plaintiff's favor, under the doctrines of subrogation, for the sum of $26,230.06.

Defendants concede in their answer that plaintiff is entitled to have allowed a claim as a general creditor, in the sum of $4,827.20.

The case was submitted to the Court on the merits, on an agreed statement of facts, with the privileges reserved to either party to offer additional evidence on the trial. Defendants offered none, but plaintiff put in evidence the depositions of two witnesses. These witnesses hardly added anything to the facts which control the case. They merely detail the history of the manner, means, and date of pay-

ment by plaintiff to Pemiscot County (hereinafter called County, simply, for the sake of brevity), and make clear the fact (as to which there is no dispute) that the plaintiff paid his surety obligation to the County by his personal check on another bank, and that this check was taken in lieu of cash by the County.

The controlling facts, as said, are agreed to, and so they are just as open to any other court as they are to this Court, without any specific findings of fact, as required by Rule 70½ of the Rules in Equity. However, ease and clarity of discussion will be augumented by a *precis* of these facts. They run thus:

On and prior to the 17th day of January, 1930, the First National Bank of Caruthersville (called herein, for brevity, simply the Bank) was a solvent banking concern, and was and had for some time been a depository of the various funds and moneys of the County, and of divers school districts and drainage districts, as well. As such depository the Bank got only one-third of the money of the County, but, obviously, that is not important.

When the Bank was made the County depository, on the 6th day of May, 1929, it was required to give, and did give, to the County, four bonds in the sum of $10,000 each, to secure County moneys on deposit. These bonds were made by four certain bonding companies, and premiums, of course, were paid therefor.

On January 17, 1930, the County, for reasons which do not appear and which, therefore, have nothing to do with the case, ordered that in addition to the $40,000 security to the County, evidenced by the four corporate surety bonds, the Bank should execute an additional bond, in the sum of $35,000, with personal securities thereon.

Plaintiff, who was at that time the President of the Bank, together with the cashier and all of the directors of the Bank, executed and delivered as sureties, with the Bank as principal, this personal security bond to the County in the sum, as said, of $35,000. The Bank, at the time of delivering this personal security bond, held some $20,000 of the

obligations of the County, called in the record County warrants, but which were drawn against divers different County funds, as also against a drainage district, a road district, and a special road district. (See, Sections 9985 to 9986, R. S. Mo., 1929.)

In order to secure themselves against loss, in becoming personal sureties for the Bank to the County, plaintiff, and the other officers and directors of the Bank, passed a resolution and entered into a contract with the Bank whereby the $20,000 in County warrants then owned and held by the Bank, should be segregated and put up as collateral by the Bank to secure plaintiff and the other officers who became co-sureties with plaintiff, against loss by reason of their becoming such sureties.

It does not appear from the agreed facts who held this collateral (save that it was held by the officers of the Bank who had signed as sureties), but, obviously, it was held in such wise as that it did not come into the hands of the receiver.

On November 25, 1930, the Bank was taken over by the Comptroller of the Currency, who duly appointed defendant, Bailey, as Receiver to administer its affairs and to wind it up. When the Bank failed the County had on deposit therein, to the credit of one "Isaac McKay, Treasurer" the sum of $56,277.37. Part of this money belonged to, or had been apportioned to and was held by the County for, well-nigh each and all of the various funds into which by law the County, through its County Court, is required to divide the County money. (See, Section 9985, *supra.*) In addition, some $42,000 of it was held by the County in such trust as the statutes of Missouri create, for some thirty-six road districts and some twenty-three different drainage districts.

When the Bank went into the hands of the receiver, it owned, including interest, $8,460.74, in County warrants (this, in addition to the $20,000 in warrants held by plaintiff and his co-sureties as collateral, as already stated), which County warrants were free assets, that is, which had

not been put up as collateral, or otherwise hypothecated. These warrants were likewise drawn against the several funds of the County and against certain road districts. The Comptroller of the Currency demanded that the County give credit to the Bank, by way of set-off, in the sum of these warrants against the County's deposit of $56,277.37 (including interest). To this set-off, the County agreed, and so the net amount to be paid to the County by the corporate and personal sureties of the Bank was $47,695.65.

When the Bank failed, one policy, or corporate surety bond for $10,000, had expired. So, there was then in force when demand for payment was, on December 1, 1930, made by the County on the corporate and personal sureties, only $65,000 in security. Each of the three remaining corporate sureties had, in their contracts with the County, a clause to the effect that they should not be liable to the County in excess of the proportion which the amount of their bonds bore to the whole security given by the Bank to the County. Thus each corporate surety became liable to pay to the County 10/65 of the net balance on deposit in the Bank to the credit of the County treasurer.

On the 27th day of February, 1931, these corporate sureties paid to the County by check, each the sum of $7,368.56, or the aggregate sum of $22,105.68, leaving a balance of $26,230.06 to be paid by the plaintiff and his co-sureties on the personal bond. This balance was paid by plaintiff in a check for $30,794.12, dated February 27, 1931, and payable to the County Treasurer, and drawn on the Bank of Caruthersville. The several sources of the money in the latter bank on which this check was drawn, are thus set out in the agreed facts:

> "That at the time said check was drawn R. L. Ward had on deposit in said Bank of Caruthersville $8925.27; that after said check was drawn he sold to said Bank of Caruthersville warrants of said county, hypothecated as aforesaid, for their face value, plus interest to that date, in the sum of $12,118.08, and deposited same on that or the next day in said bank; that thereafter,

on February 28th, 1931, the plaintiff collected from the county on part of the warrants so hypothecated, as aforesaid, the sum of $7321.85, which was deposited by him in said Bank of Caruthersville on February 28, 1931, and thereafter, on the same day, February 28, 1931, the remainder of the $20,000 hypothecated warrants were collected from Pemiscot County and deposited, together with other funds, to the credit of R. L. Ward in the sum of $2,330.68; that thereafter on March 2nd, 1931, the check given by R. L. Ward to the Treasurer of Pemiscot County aforesaid, was by said Treasurer presented for payment and paid by said bank."

By a contract found in the record and made a part of the agreed facts, the three corporate sureties waived any claim to the right to share with the personal sureties in the collateral taken by the latter to secure themselves, namely, the $20,000 worth of warrants, about which this controversy rages, so that question is out of the case.

In passing, but probably of no decisive force in the case, the defendants on June 13, 1931, and so long after the County had been paid in full, entered on the books of the Bank a set-off against the claim of the County in the sum of the then worth of the $20,000 in warrants then held partly by the Bank of Caruthersville, which had bought them, and partly by the County itself, which had paid and cancelled them. In passing, it may be said that the payment by the County for a part of these warrants was brought about by the fact that money had come into the County treasury from the cash payment made by the corporate surety. In this attempted set-off the County did not acquiesce, nor did plaintiff and his co-sureties on the personal bond acquiesce. Also, in fairness, but deemed of no decisive importance, it may be said that the County agreed by stipulation with plaintiff and the corporate sureties, to procure an allowance in its favor as a general creditor of a claim for the full amount of net balance of County deposits held by the Bank, to-wit, $47,695.65, and to assign this claim to the plaintiff and his co-sureties on the personal

bond and to the three corporate sureties, in the proportions, respectively, of 35/65 to plaintiff and the personal sureties, and 10/65 to each of the corporate sureties. Whether this was ever actually done, is dark upon the record. But since defendants had no part in this stipulation, I think it cuts no figure in the case, because, if outside of this fact other facts in the case shall warrant, the right of subrogation exists in favor of the personal sureties.

Upon the above facts, plaintiff contends for an allowance in his favor of $26,230.00, while defendant receiver concedes his right to an allowance as a general creditor, in the sum of $4,827.20. In the light of such latter concession, I need not consider whether plaintiff, absent assignment, may sue alone, without joining his co-sureties on the personal bond, for the point is nowhere raised.

Coming first to the last point mentioned above, and its legal implications: Does it at all affect the case that the County agreed to have the sum of $26,230.06 allowed in its favor and to assign the allowed claim to plaintiff? I repeat, that it is obvious that it does not. On first blush, a contrary view is plausible; this, for the reason that, while it was held in the case of *Merrill* v. *Bank*, 173 U. S. 131, that a creditor having security for his debt may hold the security and yet have his claim allowed for the full amount thereof, plaintiff is not, nor was he ever, the creditor of the Bank. The above rule long doubted, but set at rest in the national courts, at least, by the *Merrill* case, *supra*, would allow the County, as the creditor of the Bank, to have had allowed in its favor, its full claim in the sum of $47,695.65. Having done this, it might be urged that it is not at all the concern of the defendant receiver, as to whether the County shall see fit to assign its allowed claim to plaintiff or not. But the above argument overlooks a further condition, in the *Merrill* case, *supra*, which is that the creditor who is secured, may not himself obtain from his debtor more than the full sum of his demand. This the County already has, and it can take no more, nor can it by assigning

enable its assignee to get more. And so, whatever right plaintiff has here is bottomed wholly on the doctrine of subrogation and not at all through a derivative right or contract arising from assignment, even if that assignment be eked out by regarding that as done which ought to have been done. Indeed, it would seem that if regarded as bottomed on assignment, the logic of the situation, and the conclusion from the rules governing, would preclude plaintiff from recovering any sum.

How stands the matter on the right of subrogation? Generally, of course, it is well-settled that a surety who pays a debt for another stands in that other's shoes, as to the right of having a claim allowed against the debtor whose debt the surety pays. This was probably the first and earliest application of the doctrine. So, in a proper case of payment by a surety, the law conferred the right of substitution or subrogation of the surety for the creditor, in any claim against the debtor, which the surety had paid. But the doctrine is not to be applied arbitrarily, and in a way which will work injustice to any one having an interest in the subject-matter, but, on the contrary, it is to be applied in order to do justice, and avoid enriching one person at the expense of another.

Here, plaintiff who paid the $26,230.06 balance due the County, yet paid it, in large part, by using the assets of the Bank which were pledged to plaintiff to secure him on his contingent liability to the creditor, as a surety. Of his own money he put in but $4,827.20. (These figures are bottomed on the concession of the defendants; my own figures would differ slightly, but I have found the mathematical calculations in the agreed facts, utterly confused, and confounded.)

If the Bank should pay a dividend of even 20 per cent, plaintiff's part thereof, should his contention be sustained, would be the sum of $5,246, which would exceed the actual money paid by him, by some eight hundred dollars. This result equity will not countenance, and the doctrine of subrogation will not be applied when it brings about such a result (25 R. C. L. 1314). Moreover, it is fairly well-settled

law that, a surety who takes collateral from a debtor to secure a creditor of such debtor, holds such collateral for the creditor (*Jenkins* v. *National Surety Co.*, 277 U. S. 131). If, under this rule, plaintiff had turned over to the County the $20,000 worth of the County's warrants (the amount was in fact, with interest, $21,770.61) there would have been left for plaintiff to pay as a surety, only some $4,500. This turning over of the collateral would have occurred perforce the rule of the *Jenkins* case, *supra,* and not in obedience to the law of set-off contended for by defendants.

As I see the case, it is not necessary to decide whether a county, under the law of Missouri, can be compelled to set off county warrants, drawn pursuant to law (Sections 9985, 9986, R. S. Mo., 1929), upon many different funds and against money held in trust (likewise pursuant to law), for divers governmental purposes. Some of the latter, to mention but a few, are levee districts, drainage districts, school district, road districts, courthouse, jail and school building funds, and the interest and sinking funds belonging thereto. As forecast, it seems to be fairly well-settled law that a surety is not entitled to be subrogated to the claim of the creditor until the latter has been paid in full, as has already been said (*National Surety Company* v. *Salt Lake County,* 5 Fed. (2d) 34), and here the creditor was not paid in full with plaintiff's money. But this rule, after all, has little to do with the case, since it must, in any event, ride off on the rule that subrogation will not be decreed when its effect would be to work an injustice on other creditors. Rules of law must be so far general as to apply always to given states of fact in the same way. The rule urged by plaintiff would, in many cases, and probably here, allow him to reap where he had not sown.

Clearly, plaintiff used, in order to pay some $21,000 of his obligation to the County, assets which belonged to the Bank, but which were impressed by operation of law with a lien in favor of the County. These assets were not and never became the property of the plaintiff. So, he could not use them to pay his personal obligation. He could

apply them only to such use as the law and the lien thereof impressed on them required. Otherwise, he would have had no right to take these assets from the Bank whose property they were. Plaintiff was not a creditor of the Bank. As already said, the latter owed him nothing. So, cases like the *Merrill* case, *supra*, and those which followed the rule it lays down, have, I think, nothing to do with the case at bar. If plaintiff had paid his own money to the County *in toto*, he would have been entitled to an allowance by subrogation therefor. But he did not do so, except in part, and so he is entitled, perforce the doctrine of subrogation, to an allowance as a general creditor, only for that sum for which he actually became a creditor, namely, $4,827.20, and upon this sum, as a general creditor, he is entitled to participate in all dividends heretofore and hereafter declared.

A decree may be presented accordingly.

St. Louis, Missouri,
November 24, 1933.

III.

Office letters of May 17, 1932 and May 2, 1933, instructed the Receiver of the Olympia National Bank of Olympia, Washington, to allow general creditor claims to sureties on depository bonds given to secure County funds in the amounts actually paid by said sureties. Litigation ensued in this case and the decision of the United States Circuit Court of Appeals, Ninth Circuit, is reported as *Douglas* v. *Thurston County* (C. C. A. 9th, 1936), 86 F. (2d) 899.

May 2nd, 1933.

Mr. E. B. Benn, Receiver,
Olympia National Bank,
Olympia, Washington.

Dear Sir:

We have your letter dated April 19, 1933, with further reference to the Thurston County litigation signed in your behalf by James P. Neal, attorney for your trust, requesting instructions respecting the character of the answer this

office desires you to make to the cross-complaint of the surety companies, served upon you in this litigation.

This office takes the view that the rights of the parties are fixed as of the moment of insolvency and suspension of the Olympia National Bank, Scott v. Armstrong, 146 U. S. 499; Balch v. Wilson, 25 Minn. 299, 33 Am. Rep. 467; and McCandless v. Dyar, 34 Fed. (2) 989; and it appears to us that the contention of the surety companies that the collateral should be exhausted before any liability attaches to them is erroneous and that your attorney should contest this point. We believe your answer should assert primary liability of your trust with respect to the pledge of assets and the surety companies with respect to the bonds on a proportionate basis, that is to say, the liability of the bonding companies is primary and is fixed as of the amount the penalty of the bond bears to the total amount of the depository bonds and other securities which stand to secure the County Treasurer's deposit. In short we desire your attorney to assert that the pledge of the assets and the surety bonds should be considered as a primary and absolute individual or single pledge of securities, and the liability of the parties to be determined in accordance to the proportion that the pledge of assets and the bonds bears to the principle amount of the indebtedness. This necessarily negatives the theory of the surety companies that the collateral should be first exhausted before any liability attaches on the bonds. Further, the question arises as to whether or not the ratios of the securities and the bonds would be fixed in determining the liability upon the par value of the collateral or upon the market value of the collateral as of the date of the closing of the bank. It is our opinion that the rights of the parties are fixed as of the moment of insolvency and suspension, and that ratio will be determined by fixing the market value of the collateral as of the date of the closing of the bank. Since this is a favorable view, we presume the surety companies will not contest this aspect of the case.

Yours very truly,

(Signed) R. L. MILLER,
Assistant Supervising Receiver,
Div. of Insolvent National Banks.

May 17, 1932.

Mr. H. W. Douglass, Receiver,
The Olympia National Bank,
Olympia, Washington.

Dear Sir:

We have copies of the pledge agreement and surety bonds, forwarded under date of May 7, 1932, regarding the accounts due J. R. Johnston, County Treasurer, at suspension, which were secured by a pledge of assets of the trust amounting to $61,878.82 and surety bonds to the amount of $47,500.00.

It appears that under the second agreement of the bond the surety shall be liable thereunder for such proportion of the money deposited with said principal by the County Treasurer of said county, and payment of which is refused by said principal, upon demand of the County Treasurer of said county, as provided in the condition of the bond, as the penalty of the bond bears to the total amount of depositary bonds and other securities for deposits furnished by the principal to the County Treasurer of said county. It follows that this agreement establishes a proportion of liability, and the position taken by the surety company that the security held by the Treasurer of Thurston County be sold by said Treasurer and the proceeds applied upon his balance due from the bank, is not correct. The surety companies must pay their pro rata share of this account and your securities may be liquidated to the extent of the pro rata share they bear to the full amount, as the proportion of liability may be disclosed.

The surety companies, in turn, will be allowed to file a general claim against your trust for the amounts disbursed by them in the payment of this claim. You, of course, will receive the balance of the securities from the County Treasurer, after the claim has been liquidated, and the proportionate amount for which the securities are liable have been realized from the proceeds received from the sale thereof.

You may advise the surety companies and J. R. Johnston, County Treasurer, of our decision in this matter, and instruct the attorney for the Olympia National Bank trust, James P. Neal, Esq., to protect the trust in the matter and effect the result heretofore described.

Very truly yours,

(Signed) R. L. Miller,
Assistant Supervising Receiver,
Div. of Insolvent Nat'l. Banks.

IV.

The letters of May 27, 1935 and November 6, 1937 to the receiver of the First National Bank of Elizabethton, Tenn., and the motion of the receiver in the proceedings in the United States District Court in the case of *Maryland Casualty Company* v. *Cox,* Receiver of said bank, indicate office position restricting the surety's claim to the actual amount paid instead of allowance of a claim for the full amount of the deposit. The opinion of the District Court sustaining office position is not reported and hence is inserted.

The District Court was affirmed, as to this point in *Maryland Casualty Co.* v. *Cox,* 104 F. (2d) 354, 358.

May 27, 1935.

Mr. John I. Cox, Receiver
The First National Bank
Elizabethton, Tennessee.

Dear Sir:

In reply
refer to CC

This will acknowledge receipt of your letters of May 14th and May 15, 1935 having reference to the suit involving the various bankruptcy deposits with your trust, which is designated as United States of America for use and benefit of E. M. Miller, Trustee, et al, v. First National Bank, et al, now pending before the United States District Court, Eastern District of Tennessee.

At the time of the deposit of the bankruptcy funds, the First National Bank gave as security the $60,000.00 bond with sureties and pledged assets of the bank as collateral security to the $60,000.00 bond. As security for the same deposits the Maryland Casualty Company gave a bond in the amount of $17,500.00. No assets were pledged to secure the Maryland Casualty Company for their liability on this bond. The deposits have been paid in full by reason of the payment of dividends and the application of the collateral pledged by the bank as security to the $60,000.00 bond and the payment by the Maryland Casualty Company of its liability in the amount of $17,500.00. The Maryland Casualty Company having paid in full the face amount of its bond in the sum of $17,500.00, is now attempting to secure possession of the remaining assets of the bank which were

pledged to secure the $60,000.00 bond, and also asks permission of the court to file claim against the Receiver of the First National Bank for the total amount of the several trustees' deposits aggregating the sum of $50,065.83 and to receive dividends from the Receiver of the First National Bank on the basis of this amount instead of on the sum of $17,500.00 only. It appears that the case has been argued and you are now awaiting a decision by the United States District Court on the question of the right of the Maryland Casualty Company to become subrogated to the rights of the other sureties to the pledged collateral and the right to become subrogated to the payment of dividends on the deposits in the names of the trustees for the full amount of the deposits of bankruptcy funds as of the date of closing of the bank.

Your attorneys in their brief have covered quite fully the question of the right of the bank to pledge its assets to secure bankruptcy deposits and have relied principally upon the recent decision of the Supreme Court of the United States in the case of *Texas & Pacific R. R. Co.* v. *Pottorff*, 291 U. S. 245. In the recent case of *Evans* v. *New Haven Bank*, N. B. W. 72 F. (2) 664, it was held that bankruptcy deposits could be secured by a pledge of assets. See also *Fulton* v. *Lloyds Casualty Company*, 75 F. (2) 295, in which case it was held that state banks in Ohio did not have the power under the state statutes to pledge assets to secure bankruptcy deposits. In this same decision your Circuit Court of Appeals held that two surety companies which took a pledge of assets of a depository bank to secure them against losses on depository bonds executed by them covering public money of a City deposited in the bank, were not required to share the pledged assets with a third surety company which also executed a bond at about the same time to protect the same deposit.

It would appear that the decision of the United States Circuit Court of Appeals of your circuit in this last mentioned case might govern the decision of the Federal Court in the instant litigation as it is our understanding that the assets pledged on the $60,000. bond were not under any agreement pledged to secure the Maryland Casualty Company on its bond in the amount of $17,500.00. The right of a surety to subrogation in a case somewhat similar to the one now before your Federal Court is discussed in the recent case of *Ward* v. *First National Bank of Caruthersville, Mo.*,

and R. E. Bailey as Receiver, 76 Fed. Rep., 2nd Series, Advance Sheets, pg. 256.

The decisions above cited in this letter should be called to the attention of your attorneys, in view of the fact that the same would appear to apply in the case now pending before your United States District Court. Please advise this office when you expect a decision in the case pending before Judge Taylor.

Very truly yours,

H. J. HALL,
Assistant Supervising Receiver
Division of Insolvent Nat'l Banks.

LRS:DM

November 6, 1937.

Mr. John I. Cox, Receiver
The First National Bank
Elizabethton, Tennessee.

Dear Sir: Refer to CC-LD.

Reference is made to your letter of November 2, 1937 with which you forwarded a copy of the opinion entered by the United States District Court on October 27th in the case of United States of America, for the use and benefit of E. M. Miller, Trustee, et al v. First National Bank of Elizabethton, et al, in which the question involved is the right of the Maryland Casualty Company, as subrogee of the claim of the Trustees in Bankruptcy, to obtain pledged assets and their proceeds which were pledged for the purpose of securing the sureties on a $60,000.00 depositary bond and also involved the claim of the Maryland Casualty Company that it was entitled to dividends on the total deposit liability in the name of the Trustees in Bankruptcy in the amount of $50,065.83 until paid in full the amount of the Casualty Company's losses incurred by reason of the payment of the sum of $17,500.00 which it had paid to the bankruptcy trustee in full discharge of its liability as surety on a bond.

Under the decision of the court, the Maryland Casualty Company will be entitled to a general claim against your trust in the amount of $17,500.00 and will be entitled to dividends on the amount of that claim the same as any other general creditor of the bank. The court denied the Maryland Casualty Company's contention that it was entitled to dividends on the whole amount of the bankruptcy

deposits as of the date of closing of the bank and also denied the Casualty Company's claim to the remaining pledged assets or their proceeds.

Please forward a copy of the decree entered by the Federal Court in this matter as soon as it is handed down and you will, of course, advise the Maryland Casualty Company that upon receipt of a proof of claim in the amount of $17,500.00, dividends will be paid on this claim in the same proportion as have been paid to other general creditors of your trust. In the event the Maryland Casualty Company elects to appeal to the United States Circuit Court of Appeals from the decision handed down by the District Court in this matter, please advise us immediately, in order that we may give you such instructions as are necessary with respect to the position you will take in this matter.

Very truly yours,

J. H. BREWER, JR.,
Assistant Counsel.
Comptroller of the Currency.

LRS:DM

MOTION OF FIRST NATIONAL BANK—Filed September 19, 1933, by the Clerk.

In this cause come the defendants, First National Bank of Elizabethton, and John I. Cox, Receiver, and move the Court to set aside certain portions of the interlocutory decree entered in this cause on the 22nd day of December, 1932, being as follows:

(a) That portion of the decree contained in Section (3) pages 2 and 3, as follows:

"and The Maryland Casualty Company as surety on the bond of the First National Bank of Elizabethton to the United States of America for the use and benefit of the estates in bankruptcy having funds on deposit in the said First National Bank be and it is subrogated to the rights of the obligee in said bond so far as any collateral deposited by the said First National Bank of Elizabethton for the security of said bankruptcy deposits, after the said bank-

ruptcy deposits shall have been paid in full and after the satisfaction of the costs taxed and to be taxed in this cause."

(b) That portion of the decree contained in Section (7), pages 3 and 4, as follows:

"That after the payment of the costs of this cause taxed and to be taxed, and the payment in full of the bankruptcy deposits for the use and benefit of which this action was brought and decree rendered, the Maryland Casualty Company be and it is hereby subrogated to the rights of the obligee to the remaining funds, collateral, warrants and/or notes then in the hands of the Receiver hypothecated by the First National Bank of Elizabethton as security for said bankruptcy deposits as well as to any remaining dividends paid or to be paid by the Receiver of the First National Bank of Elizabethton on the claims filed with him by the Trustee in bankruptcy of the estates for whose use and benefit this suit is brought."

Defendants' motion being based upon the following grounds:

(1) Said interlocutory decree was not entered during a regular term of the Court, nor while the Court was in session hearing causes in the jurisdiction in which this suit was filed, and neither defendant or its attorney had any notice that said decree would be presented or application made to the Court to have it entered, and have had no such knowledge of the entry of said decree until within the past few days.

(2) Such portions of the decree undertaking to adjudicate the rights of subrogation are not based upon any pleadings or issues in the cause, and are, therefore, coram non judice.

(3) The defendant, Maryland Casualty Company is not entitled to be subrogated to the rights of the obligees in said bond or to any of the collateral deposited by the de-

fendant, First National Bank, for the protection of the sureties on said bond. Neither is said Company entitled to subrogation to the rights of the obligees in said bonds to any dividends paid or to be paid by the Receiver of the said First National Bank.

At the time such subrogation was undertaken, the said Maryland Casualty Company had not and did not pay the full amount of the indebtedness claimed by said obligees, and therefore, did not place itself in position to ask for subrogation.

(4) The said Maryland Casualty Company if entitled to subrogation at all, is only entitled to be subrogated to the claims of the obligees protected by its bond as against defendant, First National Bank, and/or John I. Cox, Receiver, and therefore, would be entitled to prove its claim as a creditor of said bankrupt on the basis of the amount paid by it, and to receive such dividends as may be declared and paid by the Receiver out of the trust estate.

Wherefore, defendants move that said interlocutory decree be corrected by striking therefrom the portion hereinbefore set out, and/or that said decree be corrected in such portions in the final decree now being entered in this cause.

First National Bank of Elizabethton,
(Signed) By John I. Cox,
Receiver.

(Signed)
Joseph Caldwell,
Susong, Susong & Parvin,
Attorneys for Defendants.

Filed Oct. 27, 1937.

IN THE UNITED STATES DISTRICT COURT
AT GREENEVILLE, TENNESSEE.

UNITED STATES OF AMERICA, for the use and benefit of
E. M. MILLER, TRUSTEE, ET AL.

v.

FIRST NATIONAL BANK OF ELIZABETHTON, ET AL.

Memorandum.

The remaining question for determination in this cause is the Casualty Co.'s claim for subrogation to the rights of the bankruptcy creditors and/or contribution from sureties on another bond guaranteeing the payment of the same deposits.

In order to clearly understand the rights of the parties now, their rights as of the date of suspension must be clearly understood.

When the Bank suspended it owed its creditors more than a million dollars. Among these creditors were various trustees in bankruptcy representing the creditors of estates in bankruptcy whose claims against the bank aggregated more than fifty thousand dollars.

In addition to the primary liability of the Bank on all of these indebtedness, there were in force certain bonds which furnished additional protection against loss to the creditors of bankrupt estates whose funds were on deposit to the credit of various trustees.

The Maryland Casualty Co. was surety on such a bond with a penalty or maximum liability of $17,500. The Bank was the principal obligor. This, of course, added nothing to the security of the depositors, as the Bank was already

liable as such on the deposits. When the Casualty Co. became secondarily liable on the bond, the Bank became liable to it for any losses it might incur by reason of the suretyship. This liability existed, whether express or not.

There was also in force and effect at suspension another bond executed April 14, 1931, with a maximum liability of $60,000 to secure the same depositors, signed by the Bank as principal obligor, and by a number of individuals as sureties, and on the same day and for the same purpose and also for the purpose of indemnifying the personal sureties, the Bank, pursuant to a resolution of its board of directors, assigned certain of its described assets, and provided for a substitution by the assignee trustee of same when necessary, and as agreed upon and provided for sale of same when default made same necessary.

On the same day C. L. Grindstaff executed a deed in trust of certain valuable real estate to further indemnify the same depositors, and authorized a sale of the property for that purpose if the Bank defaulted, and if he as surety to the Bank's obligation did not otherwise make good his suretyship. This was the situation when the Bank suspended on October 17, 1931 with these secured deposits in Bank in the sum of $50,065.83.

The Bank was insolvent when it suspended, and will not be able to pay its creditors, including its depositors, more than thirty per cent of their claims. In this situation the Bank closed its doors, and went into the hands of a receiver appointed by the Comptroller of the Currency.

On December 21, 1932, the Maryland Casualty Co. paid into the registry of the court the full penalty of its bond, $17,500 in full discharge of its liability under its contract.

On June 24, 1932, a receiver was appointed to take charge of all of the personalty assigned by the Bank on April 14, 1931, and to reduce same to his possession, and to collect same for the purposes for which assigned, which he has done and which collections have, together with the $17,500 paid by the Maryland Casualty Co. been applied to and fully discharged the secured deposit liability for which

the bonds were given, and other sums by the receiver collected have been applied to the costs and expenses incident to the receivership, and he has a balance on hand of $4,522.05 in cash, and certain valuable uncollected evidences of debt which were assigned by the Bank and which constitute a part of the receivership assets.

The secured depositors have been fully paid in the manner above detailed. The real estate conveyed in trust by Grindstaff was not sold and no surety on the second bond, which was executed by the Bank in the penalty of $60,000, has made any contribution, either by way of payment to depositors or to any other surety. The only payment by any surety was that of the Maryland Casualty Co., and it has had no payment to it by any principal or surety in any form, and seeks to recoup by invoking the doctrine of subrogation and/or contribution until its losses are fully paid.

The law is, of course, that in so far as the rights of other creditors are involved, the Maryland Casualty Co., when insolvency occurred, became the equitable owner of the assets of the Bank in the same percentage that its claim, through its fixed liability, was of the total claims against the Bank. As against the other creditors of the Bank that percentage must continue constant, otherwise it could happen that subsequent acts of a creditor or of a creditor and the insolvent would take from other creditors an interest which became vested with the event of insolvency. No increase in percentage of ownership, whether legal or equitable, could be accomplished without a corresponding decrease on the part of some or all other creditors.

An application of the principle, as announced in Merrill v. National Bank of Jacksonville, 173 U. S. 131, and of course applied in subsequent cases where the question has been presented and understood, results in a prohibition of the happening of any transaction or fact the effect of which would be to diminish the percentage equitable interest of any creditor in the assets of the insolvent. The validity of the Bank's pledging of its assets is immaterial. No timely objection was made to the pledgees, and the

property pledged, without timely objection, was reduced to cash and contributed to the creditors secured by the personal surety bond. The Casualty Co. contends for the validity, and Fulton v. Lloyd's Casualty Co., 75 Fed. (2d) 295, 297, leaves room for decision that sec. 101, tit. 11, U. S. C., gives national banks the right. But see T. P. R. Co. v. Pottorff, 291 U. S. 251, and 107 U. S. 450 and 56 Fed. (2nd) 799.

When insolvency was declared the bankruptcy fund creditors were in position to secure full payment. The Casualty Co. bond guaranteed it to the extent of $17,500. The Bank's personally secured bond guaranteed it to the extent of $60,000, and those who signed the $60,000 bond required the pledging of the assets to protect themselves as well as the creditors. The bond so recites. The Casualty Co. had no interest in these pledged assets and could acquire none to the prejudice of existing creditors. Fulton v. Lloyd's Casualty Co., 75 Fed. (2d), 295 (6th C. C. A.). To permit the Casualty Co. to diminish its actual contribution by acquiring, in effect, an interest in these pledged assets would diminish the dividends of the other creditors whose equitable interest to larger dividends was fixed by insolvency. This result cannot be accomplished by a change of factual basis which occurs subsequent to insolvency. The principal claim of the Casualty Co. is that it paid in part the debt of a secured creditor or creditors, and that, by subrogation, is entitled to assert the claim of all of them so paid (only in part) by it, and by claiming on the basis of the whole debt derive dividends greater than on its own claim against the Bank arising out of express or implied indemnity which arose out of its contract of suretyship. This right to claim on the whole of a debt partly secured arises out of the equitable interest which vests in creditors at insolvency of their provable share in the insolvent's assets. The security they may have held, set apart from the assets of the Bank while solvent were no part of the assets in which general unsecured creditors became vested with an equitable interest.

The secured creditors only owned these assets so set apart to the extent that they, (the pledged assets) were required to make good their deposits. The remainder, after the secured creditor was paid, was always property of the Bank, and in this residue only the equitable title vested in the creditors. Those assets, so far as pledged, have been appropriated. What remains of them belong now and always since insolvency belonged to the creditors. In them the Casualty Co. will share. The Casualty Co. is not entitled to contribution from the other sureties for it is not shown that the Casualty Co. has been required to pay or has paid any amount that these sureties would have been called upon to pay. The Casualty Co. bond was in force at the time the other sureties assumed liability, and their assumption was to secure other or additional deposits which had been made subsequent to the Casualty Co.'s bond or which might thereafter be made, and which were then secured by the Casualty Co.'s bond. It does not appear that the pledged assets which these sureties required as a condition to the assumption of the liability, plus dividends on the whole amount of the claims thus paid by them, would not have saved them harmless from any loss. This right to dividends could not be questioned, as at the time of insolvency these sureties became vested in equity to their pro rata of the unpledged assets of the Bank on the basis of their then fixed liability as sureties whether they claimed as subrogees or in their own right would be wholly immaterial.

That the Casualty Co., a paid surety, has no right to or interest in the benefits derived by the second set of sureties out of the pledged assets is settled by the case of Fulton v. Lloyd's Casualty Co., 75 Fed. (2d) 295, 297 (6th C. C. A.).

A number of questions of pleading have been raised by the parties, but there is no question presented which prevents a consideration of the meritorious questions presented involving subrogation and/or contribution, which must be denied.

The Casualty Co. will be entitled to dividends on its payment of the obligation of its bond, but not otherwise.

The order entered in this cause on December 22, 1932 purporting to grant to the Maryland Casualty Co. the right of subrogation and contribution without prejudice to the rights of the other sureties to contest said alleged right of contribution appears to have been entered inadvertently and not upon notice to the general creditors or their representative, or after hearing upon any pleadings properly presenting the question, was objected to by the receiver and action thereon reserved until its consideration became material and necessary.

What purports to be a consideration on the part of the Casualty Co., that is, the dismissal of its appeal and discharge of its admitted liability, was, of course, no consideration establishing any equity in favor of the Casualty Co., and what has been said hereinbefore is sufficient basis for a modification of said order in so far as it may be construed to give the Casualty Co. any rights prejudicial to other creditors by reason of its having discharged its named legal obligation under its bond.

The case of *United States Fidelity & Guaranty Co.* v. *McClintock*, 26 Fed. (2nd.) 944, 948, quoting and applying the principle announced by Mr. Justice Brandeis in *United States* v. *National Surety Co.*, 254 U. S. 73, 76, is not applicable to the facts here. There subrogation was allowed, and its allowance did not violate the rule or principle referred to herein and stated in *Merrill* v. *National Bank*, *supra*. The debt in *United States* v. *National Surety Co.*, *supra*, as here, had been paid in full, but there it was fully paid by funds contributed outside the assets of the bank, so that subrogation there did not change the recovery any creditor would have against the bank. There the percentage of vested equitable interest remained the same. Here if the right of subrogation should be allo ed, it would give to the Casualty Co. an interest in the Bank's assets which it not only did not have when insolvency occurred, but

which in the giving would take from other creditors of the insolvent rights which they had and to secure which they had already become vested with an equitable interest in the Bank's free assets.

(Signed) GEO. C. TAYLOR,
Judge.

V.

Office letters of January 15, 1936 and August 1, 1936 addressed to the Receiver of the First National Bank of Nephi, Utah, related to the claim of the American Surety Company as assignee of the claim of the State Land Board of Utah. The office position was that the surety company's claim for dividend purposes should be on the amount the surety actually paid rather than on the total amount of the deposit liability of the State Land Board of Utah. Suit was filed by the American Surety Company against the Receiver and the District Court of the United States for the District of Utah held for the surety in that instance. (opinion not reported). No appeal was taken from the decision in question by the receiver because further litigation would have resulted in a delay in termination of the receivership and the consequent payment of a final dividend to depositors and creditors.

January 15, 1936

Mr. W. C. Andrews, Receiver
The First National Bank of
Nephi, Utah

In reply
please refer to CC.

Dear Sir:

This will acknowledge receipt of your letter of January 6, 1936 concerning the secured deposit with your trust in the name of the Utah State Land Board. In reply to the office letter of December 21st you have submitted copies of the

two escrow agreements entered into between the First National Bank, The Utah State Land Board and the Walker Bank & Trust Company, as Trustee, under dates of November 22, 1932 and December 16, 1932, by means of which the bank pledged United States Treasury Bonds with a total par value of $6,000. as security for public money deposited by the Utah State Land Board. The deposit was also secured by a surety bond in the amount of $7,500.00 given by the American Surety Company. You advise that the liability due the State Land Board totalling $14,253.96 has been paid by a 5% ratable distribution made by the bank in July 17, 1933, the sale of the United States Treasury Bonds totalling $6,180.00 on September 1, 1934 and the payment of the balance due by the American Surety Company on July 1, 1935.

It is our understanding from your letter that the Receiver's Certificate of Proof of Claim filed by the Utah State Land Board has been assigned by the Board to the American Surety Company. You should advise us definitely whether the assignment covers the full amount of the deposit liability of the First National Bank of Utah in the sum of $14,253.96 or whether the assignment covers only the sum of $7,361.46. From the information submitted by you, we are inclined to believe that the American Surety Company would not be entitled to dividends upon the whole amount of the deposit in the sum of $14,253.96 but, on the other hand, would be entitled to dividends only upon the balance due after applying the collateral security pledged by the bank to the State Land Board. Refer Ward v. First National Bank of Caruthersville, et al, 76 F. (2) 256.

Therefore, if you find that the State Land Board has assigned its Proof of Claim to the American Surety Company for the whole amount of the deposit liability in the sum of $14,253.96 and the American Surety Company is claiming dividends as subrogee upon the whole amount of the deposit instead of upon the sum actually paid by the American Surety Company in discharging its obligation under the $7,500.00 surety bond, you are requested to have your attorney investigate this matter and advise you in order that you may inform this office as to the question of whether or not, in view of the above-mentioned decision, the American Surety Company is entitled to dividends upon the

whole amount of the deposit by reason of its having become subrogated to the rights of the Utah State Land Board.

This matter should be given your immediate attention.

Very truly yours,

(Signed) H. J. HALL,
Assistant Supervising Receiver
Division of Insolvent Nat'l Banks.

LRS:DM

August 1, 1936

Mr. W. C. Andrews, Receiver
The First National Bank
Nephi, Utah

Refer to CC-LD

Dear Sir:

Reference is made to your letter of January 20, 1936 concerning the secured deposit of the State Land Board in the amount of $14,253.96. In reply to the office letter of January 15th you advised that the deposit has been partially paid by means of a 5% dividend payment and the sale of all assets pledged to secure the deposit, from which sale the sum of $6,180.00 was derived and applied in payment of the claim. It appears that from information you have obtained, the American Surety Company has paid the State Land Board the remaining amount due on this claim because of the liability on the bond executed by the American Surety Company in the amount of $7,500.00 as security for this deposit. However, no information has been submitted to you advising that the claim of the State Land Board has been assigned to the American Surety Company.

We have heretofore called to your attention the case of Ward v. First National Bank of Caruthersville, 76 F. (2) 256, from which decision it would appear that the American Surety Company, as subrogee of the State Land Board, is entitled only to further dividends on the claim of the State Land Board based on the sum of $7,361.46.

Accordingly, at such time as you are advised that the American Surety Company, as assignee or subrogee of the

Utah State Land Board, is claiming further dividends on the Land Board's claim, you will inform the American Surety Company that further dividends will be paid on the sum of $7,361.46 only.

Very truly yours,

(Signed) KIT WILLIAMS,

Executive Assistant Counsel
Comptroller of the Currency.

LRS:DM

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF UTAH, CENTRAL DIVISION.

No. 13410.

AMERICAN SURETY COMPANY OF NEW YORK,
Plaintiff,

v.

THE FIRST NATIONAL BANK OF NEPHI, UTAH, ETC.,
Defendants.

I am of opinion that the rules laid down by the Supreme Court of the United States in *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, are applicable to the facts in the instant case, and feel that I am bound by that decision notwithstanding the decision of the Supreme Court in the case of *Erie Railway* v. *Tompkins*, 304 U. S. 64, which overrules the old case of *Swift* v. *Tyson*, 16 Peters 1.

Let findings of fact, conclusions of law and judgment be prepared by counsel in accordance with the view above expressed.

Filed in United States District Court, District of Utah, December 9, 1938. W. B. Wilson, Clerk. By V. P. Ahlstrom, Deputy.

VI.

The Receiver of the Reading National Bank & Trust Company of Reading, Pennsylvania, was instructed by office letter of February 21, 1941 to allow a general or common claim for dividend purposes to the United States Fidelity & Guaranty Company in the amount actually paid by that company to the Clerk of the United States District Court upon a depository bond given as security for various bankruptcy deposits. The surety paid in part only the total liability due the secured depositor as of the date of the bank's closing.

Feb. 21, 1941.

Mr. H. F. Dunn, Receiver
The Reading Nat'l Bank & Trust Co.
502 Penn Street
Reading, Pennsylvania

Refer to CC-LD

Dear Sir:

Reference is made to your letter of February 14, 1941 concerning dividends due the United States Fidelity & Guaranty Company because of their payment of the sum of $4,996.30 to the Clerk of the United States District Court as the company's liability as surety upon a depositary bond given as security for various bankruptcy deposits with your bank totalling $68,145.59 as of the date of suspension. The bankruptcy accounts were paid through application of collateral security pledged by the bank, the proceeds of which amounted to $46,112.97, and the payment of a first dividend of 25% in the amount of $17,036.32, leaving a balance of $4,996.30 which was paid to the Clerk of the District Court by the surety in discharge of its liability

on the depositary bond. The surety company has heretofore insisted that it was entitled to payment of the sum of $4,996.30 in full at the time a 10% dividend was declared on the theory that the basis of the payment should be on the surety's asserted subrogation rights to further dividends upon the deposit liability of $68,145.59.

When the second dividend of 10% was authorized, we advised you to withhold payment of any dividends to the surety company because of the pending case of *American Surety Company of New York* v. *Bethlehem National Bank*, recently decided by the United States Circuit Court of Appeals, Third Circuit, and now reported in 116 F. (2d) 75. A copy of the opinion of the Circuit Court of Appeals was forwarded to you with our letter of December 6, 1940 and you were requested to reexamine the claim of the United States Fidelity & Guaranty Company to determine the dividends payable to the company on a claim for the amount actually paid by the surety on the depositary bond.

The surety company is now willing to accept a common claim for the amount they actually advanced in the sum of $4,996.30. You therefore request authority to establish an additional liability in the sum of $4,996.30 and to pay dividends due on a claim in that amount.

You may advise the United States Fidelity & Guaranty Company that a general or common claim will be allowed in the amount of $4,996.30 and dividends due on such a claim will be promptly paid. A separate letter will be forwarded concerning necessary accounting instructions with respect to this matter.

Very truly yours,

(Signed) E. H. Gough,
Deputy Comptroller.

LRS:DMY
2/19/41

VII.

Correspondence Concerning Instant Case.

The letter of January 17, 1936, indicates that the receiver is, for the first time, requesting instructions from the Comptroller as to the amount of claim to be allowed the surety and consequently that the letter of the receiver to the surety, dated December 23, 1935, (R. 8) proposing to allow the

surety a claim of $122,588.56, was written without previous instructions from the Comptroller. The letter of July 9, 1936, specifically instructed the receiver to allow a claim of $68,588.56, constituting the amount paid by the surety. That letter refers to the Comptroller's letter of April 10, 1936, (which was in response to the receiver's letter of January 17, 1936) and indicates that the receiver had previously been advised that the surety's claim must be restricted to $68,588.56. Following the aforesaid letter of July 9, 1936, the receiver wrote the surety on July 11, 1936, (R. 9) advising the surety of the limitation of its claim to $68,588.56.

Paragraph 14 of the Bill of Complaint (R. 6) refers to an offer by the receiver to the surety, under date of August 30, 1939, to allow the surety a claim of $122,588.56. A search of our files discloses no letter either authorizing or relating to said offer of August 30, 1939. Counsel for petitioner has today (November 13, 1941), by telephone, authorized the insertion of the following statement by the undersigned as counsel for respondent:

> "With reference to the admitted allegation in paragraph 14 (R. 6) concerning the offer of the receiver of August 30, 1939, I am advised by counsel for petitioner that this offer was orally made by the receiver during the course of a conference on that date attended by the receiver, counsel for the petitioner, and local counsel for the receiver."

It will be noted that the offer of August 30, 1939, was made by the receiver and not by the Comptroller, and that the correspondence indicates that said offer was not authorized under the previous instructions given by the Comptroller.

January 17, 1936.

Comptroller of the Currency,
Treasury Department,
Washington, D. C.

Re: Advice Relative to Deposit Account.

Dear Sir:

I desire to advise you that the Commonwealth of Pennsylvania had on deposit with The Bethlehem National Bank, as of the closing date on March 4, 1933, deposits amounting to $135,000.00, as detailed in the following schedule:

Detail	Amount
Federal Unemployment Relief Fund	$65,000.00
Motor License Fund	70,000.00
Total	$135,000.00

A first dividend of 40% amounting to $54,000.00 was distributed to the Commonwealth of Pennsylvania on or about February 17, 1934, and it appears that collateral comprising 12M United States Treasury Bonds, 3⅛%, 1946-1949, were pledged with the Commonwealth of Pennsylvania, as collateral security for these deposits. I am enclosing herewith a copy of an instrument executed by the officers of The Bethlehem National Bank on January 17, 1933, relative to the pledging of these securities to the depositor. On April 23, 1934, the above-mentioned collateral was sold for a consideration of $12,411.44, and the proceeds were applied to the partial liquidation of the deposit liability of the Commonwealth of Pennsylvania.

In accordance with an instrument executed May 10, 1934, the Commonwealth of Pennsylvania assigned the unpaid balance of the account to the American Surety Company. In computing the second dividend amounting to 20% to be distributed to the American Surety Company as assignee,

the following method was pursued in the determination of a second dividend in the amount of $19,553.13 actually due the assignee:

Original deposit of the Commonwealth of Pennsylvania, as of March 4, 1933, and subsequently assigned to the American Surety Co., on May 10, 1934	$135,000.00
Deduct: Proceeds from sale of 12M United States Treasury Bonds, 3⅛%, 1946-1949 pledged to the Commonwealth of Pennsylvania as collateral for these deposits, and sold April 23, 1934	12,411.44
Net Deposit	$122,588.56
First Dividend of 40% actually paid (40% of $135,000.00)	$ 54,000.00
Correct amount of First Dividend amounting to 40% (40% of $122,588.56)	49,035.42
Net Excess Payment	$ 4,964.58
Second Dividend of 20% (20% of $122,588.56)	$ 24,517.71
Deduct: Excess payment in connection with distribution of First Dividend	4,964.58
Net Amount of Second Dividend	$ 19,553.13

A second dividend amounting to 20% was approved by your office on December 10, 1935, and I am enclosing herewith a copy of a letter received from this company dated December 28, 1935, reflecting the objections to the computation of the dividend as disclosed in my communication. Will you kindly advise me whether my computation with respect to the payment of the second dividend is correct.

Respectfully,

HARRY MARGOLIS,
Receiver.

HM:CF
Enc. (2)

July 9, 1936.

Mr. Harry Margolis, Receiver
The Bethlehem National Bank
Third and Adams Streets
Bethlehem, Pennsylvania

Reply to CC-LD

Dear Sir:

Reference is made to your letters of April 20th, May 20th and June 12th concerning the secured deposit with your trust in the name of the Commonwealth of Pennsylvania in the amount of $135,000.00. You have forwarded a copy of the instrument dated May 10, 1934 wherein the Treasurer of the Commonwealth of Pennsylvania agreed to subrogate the American Surety Company of New York to all the rights and remedies of the Commonwealth of Pennsylvania to the extent of $70,738.90 against the Bethlehem National Bank and assigning to the American Surety Company the claim filed by the Treasurer of the Commonwealth of Pennsylvania against the bank.

It is our understanding that the total amount of the deposit plus interest earned under the contract of deposit up to the date of closing was in the amount of $135,000.00. The $12,000.00 par value United States Treasury bonds pledged by the bank with the Commonwealth of Pennsylvania as additional security for the state deposit were sold and the proceeds thereof applied in reduction of the liability due the Commonwealth. A first dividend check of 40% was also paid the Commonwealth on its claim, leaving a balance of $68,588.56, which last amount was paid by the American Surety Company to the Commonwealth of Pennsylvania, because of the Surety Company's liability as surety on a depositary bond in the amount of $125,000.00, dated December 10, 1928.

The American Surety Company is now claiming that it is entitled to dividends now due and payable on the whole amount of the deposit in the name of the Commonwealth of Pennsylvania on the grounds that the American Surety Company became subrogated to all the rights of the Commonwealth on its claim against the bank when the American Surety Company paid the remaining amount due the Commonwealth in the sum of $68,588.56.

In our letter of April 10th we advised you that due to the decision of the United States Circuit Court of Appeals in

the case of Ward v. First National Bank of Caruthersville, 76 F. (2) 256, it was our opinion that under that decision the American Surety Company is entitled to future dividends on the sum of $68,588.56 only and is not entitled to dividends as they are due and payable on the whole amount of the Commonwealth of Pennsylvania deposit as of the date of closing. In other words the American Surety Company paid out of its own funds the sum of $68,588.56 as the principal amount still due the Commonwealth of Pennsylvania after the bank paid a 40% dividend and after the bank's assets pledged to the Commonwealth were applied in partial reduction of the indebtedness. It is our position therefore that the American Surety Company is entitled to the second dividend now due and payable in the amount of 20% on the sum of $68,588.56 only and to such further dividends as may be paid in the future on this amount.

We note that the American Surety Company is also claiming that they are entitled to the payment of dividends on interest alleged to have accrued on the secured deposit after the date of closing of the bank. This claim must be denied.

The only claims entitled to allowance in the liquidation of a national bank are those in existence on the date of insolvency. Refer White v. Knox, 111 U. S. 784; Merrill v. National Bank, 173 U. S. 131. Your Circuit Court of Appeals has held in the case of Richman v. First M. E. Church of Collingswood, N. J., 76 F. (2) 344, that a secured creditor of an insolvent national bank is not entitled to interest on his secured deposit after the date of closing of the bank. We are enclosing herewith a copy of the decision of the United States District Court, Western District of Oklahoma, in the case of Fash v. First National Bank of Alva, in which case it was held that a secured creditor was not entitled to interest on his deposit after the date of closing of the bank, even though the creditor held collateral security for the deposit. To this same effect see the decision of the Appellate Division of the Supreme Court of New York in the case of Louis Pink, Supt. of Insurance v. Harriman National Bank & Trust Company, copy enclosed. This rule has been followed in the liquidation of insolvent state banks. Refer to the decision of the Supreme Court of Oklahoma in the case of In Re American Bank and Trust Co. of Ardmore, 55 Pac. (2) 470.

After you advise the American Surety Company with respect to the dividends due that Company as subrogee of the Commonwealth of Pennsylvania on the claim hereinabove discussed, you should advise this office relative to the reply received by you, and in the event suit is filed, copies of any and all pleadings should be submitted immediately to this office in order that we may be fully informed relative to all developments. You are instructed to submit to us for examination before filing, any brief which your attorney prepares in the event suit is commenced against you.

In the event the American Surety Company files a suit in the state court, you will have your attorney immediately remove the same to the Federal court as a suit involving the winding up of the affairs of an insolvent national bank. Refer Studebaker Corporation v. First National Bank, 10 Fed. (2) 590; Larabee Flour Mills v. First National Bank, 13 F. (2) 330. When such a petition and bond for removal is filed in the state court, the case is in fact removed, all jurisdictional questions being for determination by the Federal court on petition to remand. Williams v. N. Y. P. & N. Ry. Co., 11 F. (2) 363 and Herbert v. Roxana Petro. Corp., 12 Fed. (2) 81.

Very truly yours,

KIT WILLIAMS,
Executive Assistant Counsel Comptroller of the Currency.

Approved,
(Signed) GIBBS LYONS,
Deputy Comptroller.

Enclosure
LRS:DM

Oct. 27, 1939.

Mr. Benjamin Nieman, Receiver
The Bethlehem National Bank
115 East Third Street
Bethlehem, Pennsylvania

Dear Sir:

Reference is made to your letter of October 9, 1939 with which you forwarded a copy of a bill of complaint filed in the United States District Court, Eastern District of Penn-

sylvania, in the case of *American Surety Company of New York* v. *The Bethlehem National Bank and Benjamin Nieman, as Receiver.*

In this case the surety company is endeavoring to obtain as assignee or subrogee of the claim of the Commonwealth of Pennsylvania dividends on the original claim filed by the Commonwealth of Pennsylvania in the amount of $135,000.00. In our letters of June 15th and June 28th we asked that your counsel look into the question of the amount due on the claim of the American Surety Company and at that time we called your attention to the decision of the United States Circuit Court of Appeals, Sixth Circuit, in the case of *Maryland Casualty Co.* v. *Cox,* decided June 7, 1939 and now reported in 104 F. (2d) 354 (rehearing petitions denied). This decision as well as the case of *Ward* v. *First National Bank of Caruthersville,* (C. C. A. 8th, 1935) 76 F. (2d) 256, appear to sustain your position that the surety company in this case is not entitled to dividends upon the claim of the Commonwealth of Pennsylvania, but on the other hand is entitled to dividends only on the amount it actually paid as surety on the depositary bond.

While we believe most of the legal questions involved are discussed fully in the cases cited in our letters of July 9, 1936, June 15, 1939 and June 28, 1939, please call to the attention of your counsel the following cases to the effect that attorney fees prayed for by a claimant in a case such as this cannot be allowed against an insolvent national bank. *Fash* v. *First National Bank of Alva,* (C. C. A. 10th, 1937) 89 F. (2d) 110, 112; *Pink* v. *Harriman National Bank & Trust Co.,* (1936) 287 N. Y. S. 461, 463; *Citizens Bank* v. *Thornton,* (C. C. A. 5th, 1909), 174 Fed. 752, 763.

We note your statement that your counsel has moved for summary judgment on the pleadings. As you forwarded a copy of the bill of complaint only, please transmit copies of all other pleadings filed and copies of all briefs which are submitted to the court in this case, addressing your reply to the Comptroller of the Currency for the attention of Mr. Stover.

Very truly yours,

GEORGE P. BARSE,
General Counsel,
Bureau of Comptroller of the Currency.

LRS:DMY
10/26/39

FILE COPY

Office - Supreme Court, U. S.
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, AND L. M. REED, AS RECEIVER OF THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA,
Respondents.

BRIEF ON BEHALF OF THE UNITED STATES FIDELITY AND GUARANTY COMPANY AS AMICUS CURIAE.

W. PAGE DAME, JR.,
Attorney for United States
Fidelity & Guaranty Company,
as Amicus Curiae.

The Daily Record Co. Print, Baltimore.

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Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF ON BEHALF OF THE UNITED STATES FIDELITY AND GUARANTY COMPANY AS AMICUS CURIAE.

STATEMENT.

Permission of Counsel for both sides first having been secured, in accordance with Rule 27, (9), of the Supreme Court of the United States, the United States Fidelity

and Guaranty Company files this brief herein as Amicus Curiae. The United States Fidelity and Guaranty Company is a Corporation of the State of Maryland, chartered especially to engage in the business of suretyship and, by reason of that fact and further because it itself has now pending an identical claim against another insolvent national bank, it is directly interested in the determination of this case.

I.

FACTS.

Since the facts of this case have been set out at length in the briefs for Petitioner and Respondents herein, they will only be summarized here.

To secure its deposit in the respondent bank, the Commonwealth of Pennsylvania received a surety bond in the amount of $125,000. with the Respondent Bank as principal and the Petitioner as surety. At the date of the closing of the bank the deposit secured by this bond was in the amount of $135,000.00. The Commonwealth recovered a portion of this deposit by the sale of bonds, which the bank had pledged with it as additional security, and recovered a further portion of the deposit from the payment by the Receiver of a first liquidating dividend in the amount of 40% of the whole deposit. The surety paid, therefore, the difference between the total of these two sums and the amount of the Commonwealth's deposit, such payment being in the amount of $68,588.56. Thereafter, the surety asserted the right to receive further dividends upon the basis of the entire deposit amount up until such time as such dividends might have repaid it the amount paid under its bond. The Receiver refused to pay dividends based on this amount but, instead, suggested various other amounts

upon which the dividend should be computed. Three further dividends have been paid by the Receiver to other creditors of the bank since payment of the initial dividend received by the Commonwealth; but, because of the dispute as to the proper basis upon which the Petitioner was to be paid, no portion of any of these dividends has been paid to the Petitioner. The Petitioner thereafter instituted this suit seeking to recover dividends upon the basis of the $135,000.00 deposit and for the recovery of interest thereon. The District Court in its decision held that the Petitioner was entitled to the dividends upon the basis alleged by the Petitioner, but, upon the appeal, the Circuit Court of Appeals for the Third Circuit reversed that decision holding that the dividends should be calculated and paid only on the basis of $68,588.56, the amount of the payment by the Petitioner to the Commonwealth.

II.

PRINCIPAL QUESTION PRESENTED FOR DETERMINATION BY THIS COURT.

May a Depository Surety for an Insolvent National Bank, who has made Depositor whole by a Payment of a less amount than that of the Deposit, be entitled by means of Subrogation to receive Dividends based upon the Full Amount of the Creditor's Deposit or shall it be Limited to Dividends upon the Amount of the Surety's Actual Payment?

It is the contention of the Petitioner that the surety in such a case should be entitled to receive dividends based upon the full amount of the deposit. The U. S. F. & G. Co. as Amicus Curiae entirely agrees with this view and submits that such result is in accordance with the settled law as laid down by this and other Courts.

III.

SUMMARY OF ARGUMENT.

In support of that decision, the following propositions are advanced:

(1) The Amount of any Claim Against an Insolvent National Bank for Dividend Purposes is fixed as of the date of the Closing of the Bank.

(2) Dividends Paid on All such Claims Shall be Ratable.

(3) No Equity exists on the Part of the Other Creditors of the Bank that would Prevent the Full Application of the Doctrine of Subrogation.

(4) All Dividends to which such Claim may be Entitled in Excess of the Amount Needed to Make the Depositor Whole are for the Benefit of the Surety, who by his Payment has Helped Satisfy the Depositor's Claim against the Bank.

IV.

ARGUMENT.

(1) The Amount of any Claim Against an Insolvent National Bank for Dividend Purposes is fixed as of the date of the Closing of the Bank.

It has been settled by numerous decisions of this Court that the amount of any claim against an insolvent bank for dividend purposes is fixed as of the date of the closing of the bank. *Merrill v. National Bank of Jacksonville* (1899), 173 U. S. 131; *White v. Knox* (1884), 111 U. S. 784. The creditors of the bank as of that date have a vested interest in its assets and no later transactions can in any manner operate to change the amount of any

claim as of the date of insolvency. In our case, therefore, on the date of insolvency the Commonwealth of Pennsylvania was a creditor of the bank to the extent of $135,000.00, the amount of its deposits. The Petitioner, on the other hand, had no claim whatsoever as of that time in any fixed amount as no payment of any sort had been made on behalf of the bank under its bond.

By its later payments to the Commonwealth, it did not reduce the amount of the Commonwealth's original proven claim. It simply acted as it was bound to act under its bond to repay that portion of the deposit which the bank, its Principal, had failed to pay.

In the case of *Maryland Casualty Company v. Cox* (1939), 104 Fed. (2d) 354, one of the cases most relied on by the respondents, the Circuit Court of Appeals for the Sixth Circuit considered a very similar situation to the one presented in this case and held that the surety should only be entitled to be subrogated to the extent of its payment. That Court, in its opinion at page 358, stated:

> "It does not follow, however, that the appellant on paying its obligation to the trustees acquired the right to collect the aggregate of their claims against the bank. It is as though the appellant had purchased a part of the debt. It did not pay the whole debt and is not entitled to collect upon the whole debt even though it may be subject to its portion of the debt the lien of the collateral which secures every part of it. Had the other sureties cancelled their obligations they too would under the theory of subrogation here advanced be entitled to claim dividends on the aggregate of the deposits. This cannot be the law."

In that case several sureties were involved, and the Court thus stated that to allow subrogation of each of the sureties to the aggregate amount of the deposit, might mean that two or three sureties would each be entitled to receive dividends on a claim equal to the amount of the whole deposit and to thus, in effect, make the bank pay on a far greater amount than it should. The error that, in our opinion, the Court committed, however, was in assuming that a surety, in thus paying a part of a claim, was purchasing a part of the original claim and was thus securing for himself, alone, one portion of the original total obligation. Nothing could be further from the fact as in no sense of the word is a surety, in making such a payment, purchasing a part of the debt. The surety is paying that balance which is yet outstanding after applying collateral and whatever dividends have been previously paid, and in so doing, it is fulfilling the duty that the bank owed to the depositor to repay the deposit in full. The bank still has the obligation to perform and to pay the original debt, but only the original debt—nothing more. The fact that one or more sureties will thus take the proceeds of that performance, however great or small it may be, does not affect the obligation of the bank to perform. If, in fact, more than one surety is involved, they will then apportion among themselves whatever the bank may pay on its primary obligation. They will not, and cannot, create additional claims upon which the bank must pay dividends.

So, here, the original debt is not affected. It stands as it did as of the date of insolvency, and there is no portion of it that has been subtracted from the whole to stand alone. The bank's obligation is unaltered, a new ultimate beneficiary of its performance being the only change.

The *Merrill* case, supra, settled the point that payment by means of realizing on collateral held by the depositor, did not change the original obligation, and certainly the payment of the depositor, by having him realize on the promise of a surety, likewise should not in any way affect the obligation of the bank to pay on the full amount of its primary debt.

(2) Dividends Paid on All such Claims Shall be Ratable.

The National Banking Act, *Revised Statutes, Section 5236, 12 U. S. C. A., Section 194,* states that "* * * the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction. * * *"

It would seem that the only way for a ratable dividend to be paid on the Commonwealth's deposit of $135,000 would be to keep that amount as the total of the bank's obligation as regards that deposit. That being done, it would make no difference as to the nature or number of the ultimate beneficiaries of the dividends paid. The depositor might continue to share in them until satisfied, and thereafter one or more sureties would receive them for their benefit, but as long as the original claim remains the same, everyone interested in that claim can be assured that it will always receive its ratable share of the assets of the insolvent.

When an attempt is made to alter the amount of the original claim after it has been proven, as was the case here, then to the extent of the alteration it will fail to get its ratable share of the dividends. It cannot be contended that the original claim has been satisfied in part and has survived in part, and at the same time, contend that the original claim is continuing to be ratably treated.

From the moment that any happening after insolvency is allowed to reduce the amount of the original claim, then at that time the proportionate value of such a claim in relation to the total value of claims filed, is undoubtedly altered. Any payments made thereafter could not be ratable because the basis for such distribution would be changed, and the other claims would receive proportionately more as the altered claim was given less.

It is the contention of the respondents:

> "That the fact that the principal has become insolvent and has been placed in liquidation proceedings does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, supra, page 6, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under the bond" (Resp. Brief, p. 8).

It is entirely correct that the fact of insolvency itself should in no manner be permitted to enhance the amount of the surety's claim. Such a result is not sought in this case. The surety's claim is fixed at the amount which it has had to pay under its bond, but in an effort to recover that claim, it is proceeding under its right of subrogation to insist that the claim of its obligee be given fair and ratable consideration so that, to the extent of any further dividends paid, the surety would be thus reimbursed. The total amount recoverable by the surety is measured by the amount it is required to expend for the benefit of the creditor. Such amount recoverable, however, is not to be confused with the amount that should be used as the basis for the payment of dividends which go, in turn, to be credited on the amount recoverable by the surety. The amount recov-

erable by the surety need not be, and in most cases is not, the amount upon which the insolvent should pay dividends in order to satisfy, as far as possible, its original obligation to the creditor, and through the creditor, to the surety. The fact of insolvency, therefore, neither increases nor decreases the amount of the provable claim.

(3) No Equity exists on the Part of the Other Creditors of the Bank that would Prevent the Full Application of the Doctrine of Subrogation.

By operation of the doctrine of subrogation, the rights and remedies which a creditor has against the debtor to allow him to recover the debt vest in a surety paying such debt. This is done to thereafter enable the surety to make recovery from the debtor whose primary responsibility it is that such debt be paid.

Arant on Suretyship 360.
Stearns, Law of Suretyship (4th Edition) 426.
Sheldon on Subrogation (2nd Edition), Section 1.
60 C. J. 723, Section 35.

The doctrine, of course, is equitable in its nature and because of that fact, will not be applied where an inequitable result would be obtained. It is used to further a fairness of treatment among all parties concerned and any court, in applying it, must look to see that no innocent person's rights are prejudiced thereby. If, in this case, the other depositors of the bank could show that the application of this doctrine resulted in their being treated unfairly, then, of necessity, any court would refuse to fully apply it. However, such is not the case.

At the time of insolvency, certain obligations of the bank were in existence, and the relative position of all creditors was fixed by the amount of the claims against the insolvent at that time. If there had been no surety bond given the Commonwealth of Pennsylvania, the bank instead, would have had to secure the deposit entirely by the pledge of its own bonds, which it did only to a limited degree in this case. The Commonwealth of Pennsylvania would have then continued to the end of the liquidation proceedings to receive dividends upon the full amount of $135,000, and no creditor of the bank would have been heard to say that such result was prejudicial to his interests. It can be seen, therefore, that by the device of securing a surety bond, the bank was enabled to retain among its assets $125,000 worth of bonds which it otherwise would have been forced to pledge with the Commonwealth in order to give the Commonwealth the equal protection afforded by the surety bond. The surety bond, therefore, stands simply in lieu of the equal amount of collateral which the bank would have otherwise pledged so that the recovery under that surety bond should be considered precisely the same as recovery from other collateral pledged by the bank. Therefore, if the same dividends were paid on this claim, but were thereafter divided between the Commonwealth and its surety, no different method of treatment would be thereby accorded to the other creditors.

The Commonwealth was certainly entitled to file a claim for the entire amount of its deposit and, as a matter of fact, it was in duty bound to do so in order to fully protect the surety. Stearns in his "Law of Suretyship (4th Edition)" at page 451, says:

> "The right of the surety to insist upon the entire claim being proved seems clear for, if under these circumstances, the dividend is augmented so that together with what the surety has paid, the sum exceeds the debt, the surplus would belong to the surety by the application of the doctrine of subrogation."

and again at page 452:

> "It is held that where an insolvent dies or his assets are administered through insolvency proceedings, and a creditor holds collateral security for his debt upon which he realizes less than the amount of the debt, that he may prove his entire claim against the estate of the decedent or insolvent and make no account of the collateral until he is paid in full. Such right in the creditor carries a corresponding right to a surety in the application of the doctrine of subrogation."

The bond here is not, as is contended by the respondents, an asset which is to be utilized for the benefit of the bank's creditors in the event of insolvency. Such a contention would imply that the surety had simply given a policy of insurance to the bank, entitling the bank to collect the amount of the bond for the benefit of its general creditors in the event of insolvency. Clearly this is not the obligation of this bond. Neither the bank, itself, nor other creditors of the bank, can insist that any funds be paid into the hands of the receiver to augment the dividends payable to general creditors. The obligee of the bond, however, may insist that his individual debt be made good, as the essence of the surety's obligation is to see to it that a particular creditor is made whole if the bank is unable to repay the deposit. The surety, under no circumstances, need pay more under his bond than will satisfy that particular creditor. There is no obli-

gation to pay to the receiver of the bank or other creditors the full amount of its bond.

Counsel for the respondents, in arguing that this depository bond was an asset of the insolvent bank for the benefit of all creditors, attempted to support that theory by the citation of *United States Fidelity & Guaranty Company v. Wooldridge* (1925), 268 U. S. 234. In that case, the guaranty company had written a fidelity bond in favor of a bank covering the president of that bank, which bond agreed to refund the bank the amount lost through any dishonesty of its president. Such a bond, of course, as Justice Holmes stated in that case, is truly an asset of the bank for its whole number of creditors, as the bank, itself, was the obligee therein entitled to protection against, and reimbursement for, any defalcation on the part of the president which would cause financial loss to the bank. However, the depository bond involved in this case is one in which the bank is now the principal, the obligee being one of its depositors. The bank now is the one to perform—not to seek performance, and is in no manner entitled in and of itself to demand that any amount of money be paid into its hands to increase its assets for distribution to general creditors. The Commonwealth, as obligee, alone is entitled to any performance by the surety under this bond. It is, therefore, obvious that the *Wooldridge* case, supra, has absolutely no application with regard to the status of the bond involved here, as there is an utter dissimilarity in the obligation of the two bonds.

If the contention of the respondents be upheld in this matter, it would make for the most varying and fortuitous results in the repayment of any such surety, as the amount recoverable by a surety would then depend

upon the whims of the other parties to the transaction rather than upon such surety's inherent right of reimbursement. If, for example, the depositor should hold other collateral, the amount of the surety's recovery would vary depending upon whether or not such collateral was sold and applied to the debt prior to the time that the surety made payment; it again would vary should any dividend be paid the depositor prior to the time of the surety's payment. Certainly it is not the policy of the law to establish a doctrine which will result in such unequal treatment; but, on the other hand, the law should always strive to establish principles that will bring about uniform and certain treatment and which will avoid the element of chance and caprice of parties as far as possible. The Court in *In Re Thompson*, 300 Fed. 215, in holding that a paying surety was entitled to recover from an insolvent co-surety on the basis of the creditor's full claim, was motivated by its desire to seek just such uniform result, as it stated on page 217:

> "The application of this rule makes the rights of the paying surety fixed and certain instead of uncertain and depending on the caprice or election of the creditor to proceed, first against the insolvent or against the solvent surety, causing different results to the paying surety."

(4) All Dividends to which such Claim may be Entitled in Excess of the Amount Needed to Make the Depositor Whole are for the Benefit of the Surety, who by his Payment has Helped Satisfy the Depositor's Claim against the Bank.

By virtue of the fact that several parties will participate in sharing the proceeds from a proven claim, the debtor's obligation to pay that claim to the fullest extent possible is unchanged, and when dividends have made

whole the primary creditor or obligee, he then retains any further dividends in the capacity as trustee for the surety or sureties who have made him whole.

U. S. F. & G. Company v. McClintock, 26 Fed. (2d) 944.

Fouts v. Maryland Casualty Company, 30 Fed. (2d) 357. (C. C. A., Fourth Circuit, Cert. denied, 279 U. S. 852).

Young v. Gordon, 219 Fed. 168 (C. C. A., Fourth Circuit).

To the same effect, see:

Hanson v. Tyler Auto. Company, 286 Fed. 161.

Oakland County v. Central West Casualty Company (Mich.), 254 N. W. 158.

Minshull v. American Surety Company (Wash.), 252 Pac. 147.

In the last cited case the right of the surety to receive dividends on the entire indebtedness of the principal appears to have been allowed, although, as in the case at bar, proceeds from collateral held by the obligee had been applied in part payment of the deposit, the balance having been paid by the surety on the depository bond and the surety on the official bond of the county treasurer. The sureties were allowed to pro rate dividends paid on the *entire* amount of the deposit.

The Court in the *Fouts* case, supra, stated on page 359 that the surety, through subrogation, "should receive all dividends payable to the state treasurer over and above the amount added to the casualty companies payment on the bond necessary to satisfy his claim."

Certainly if such method of reimbursement of the surety has been approved, there would seem to be no reason to prevent such dividends being paid directly to any surety rather than have them paid first to the

creditor and by the creditor thereafter turned over to the surety. There is nothing in the procedure involved in having the dividends pass through the hands of the creditor which would give the surety a greater right to ultimately receive them simply because they had made this detour on the way to him. If the contention of the respondents here be upheld, certainly the rule as laid down in such cases as these would be entirely overturned.

V.

CONCLUSION.

It is therefore respectfully submitted that in order to pay a ratable dividend on the claim of the Commonwealth of Pennsylvania which was fixed in amount for the purpose of dividends as of the date of insolvency, *Merrill v. National Bank of Jacksonville, supra,* it will be necessary to allow the Commonwealth's surety to receive dividends based on the amount of that deposit up until the time that the surety has been reimbursed for the amount that it has paid under its bond. To hold otherwise we contend would be to destroy the fundamental requirement of the law; namely, that dividends on all such claims shall be ratable and, therefore, we believe that the decision of the United States Circuit Court, Third Circuit, is erroneous and should be reversed, and that the decision of the United States District Court for the Eastern District of Pennsylvania is correct and should be sustained.

Respectfully submitted,

W. PAGE DAME, JR.,
Attorney for United States
Fidelity & Guaranty Company,
as Amicus Curiae.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1941.

American Surety Company of New York, Petitioner,
vs.
The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, as Receiver of the Bethlehem National Bank of Bethlehem, Pennsylvania.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 8, 1941.]

Mr. Justice Frankfurter delivered the opinion of the Court.

The facts of this case are simple. The Commonwealth of Pennsylvania had $135,000 on deposit in the Bethlehem National Bank. This deposit was secured by a $125,000 bond, upon which the plaintiff was surety, and by a pledge of government bonds having a par value of $12,000. The bank became insolvent, and a receiver was appointed. Thereafter the Commonwealth obtained, in round figures, $12,500 from the sale of the collateral and $54,000 as a 40% dividend on its claim, a total of $66,500. The remaining $68,500 was paid by the surety, thereby fully satisfying the Commonwealth's claim. The present suit arose out of three further dividends, of 20%, 10%, and 5%, respectively, declared by the receiver. The surety sought dividend payments on the basis of the original indebtedness, that is, $135,000. The receiver insisted that the extent of the surety's participation must be measured by the sum actually expended to discharge its principal's obligation, to wit, $68,500. Reversing the decision of the District Court, 33 F. Supp. 722, the Circuit Court of Appeals for the Third Circuit upheld the receiver's contention. 116 F. 2d 75. In view of conflicting expressions by the lower courts upon a question so important in the liquidation of national banks, cf. *Maryland Casualty Co.* v. *Cox*, 104 F. 2d 354; *Ward* v. *First National Bank*, 76 F. 2d 256; *Fouts* v. *Maryland Casualty Co.*, 30 F. 2d 357, we brought the case here. 312 U. S. 677.

The National Bank Act provides for the "ratable" distribution of assets of insolvent national banks. R. S. § 5236; 12 U. S. C. § 194. The question for decision is therefore one of federal law. *Deitrick* v. *Greaney*, 309 U. S. 190, 200-01; *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131; *Davis* v. *Elmira Savings Bank*, 161 U. S. 275; *Cook County Nat. Bank* v. *United States*, 107 U. S. 445, 448. Congress has seen fit not to anticipate by specific rules solution of problems that inevitably arise in national bank liquidations. Instead, it chose achievement of a "just and equal distribution" of an insolvent bank's assets through the operation of familiar equitable doctrines evolved by the courts. *Davis* v. *Elmira Savings Bank*, 161 U. S. 275, 284; *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 267. Among the oldest of these doctrines is the rule of subrogation whereby "one who has been compelled to pay a debt which ought to have been paid by another is entitled to exercise all the remedies which the creditor possessed against that other". Sheldon, Subrogation (2d ed.) § 11; see *Hampton* v. *Phipps*, 108 U. S. 260, 263; *Hodgson* v. *Shaw*, 3 Myl. & K. 183, 191; *Hayes* v. *Ward*, 4 Johns Ch. 123, 130.

Here the surety was compelled to pay to the Commonwealth $68,500 which ought to have been paid by the bank. Of course it succeeds to the Commonwealth's right to receive payment of $68,500 from the bank—and in no event can the surety receive more. But as a means of enforcing this right the Commonwealth was entitled to share in all future dividends on the basis of its original claim of $135,000. *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131. Succeeding to the creditor's right, the surety also succeeds to the creditor's means for enforcing it. The surety is a special kind of secured creditor. For its claim against the principal is secured by its right of subrogation to the remedies of the creditor which it has been compelled to pay. Of course, this right can be availed of only by a surety alert in discharging its duty, *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 267, and one not guilty of inequitable conduct, *United States* v. *Ryder*, 110 U. S. 729, 737. In other respects a right of subrogation is as much in the nature of a security as is a mortgage.

A "ratable" distribution requires that dividends be declared proportionately upon the amount of all claims as they stand on the date of the insolvency. This is settled law. *White* v. *Knox*, 111 U. S. 784, 787; *Merrill* v. *National Bank of Jacksonville*, *supra*, at

143; *Ticonic Bank* v. *Sprague*, 303 U. S. 406, 411. "The distribution is to be 'ratable' on the claims as proved or adjudicated, that is, on one rule of proportion applicable to all alike. In order to be 'ratable' the claims must manifestly be estimated as of the same point of time, and that date has been adjudged to be the date of the declaration of insolvency". *Merrill* v. *National Bank of Jacksonville, supra*, at 143. The basis of participation in the bank's assets by the Commonwealth was $135,000, the amount of the claim on the date of insolvency. The amount of the claim having been thus fixed on the date of insolvency, it did not shrink because of the extraneous circumstance of the creditor's forethought in securing partial satisfaction of its loss by going against the collateral and the surety.

To permit the surety to stand in the shoes of the secured creditor whose claim it has paid does not prejudice the rights of the general creditors. The extent of their participation in the distribution of the Bank's assets was fixed on the day it became insolvent. The surety will receive no greater share than would have been received by the Commonwealth had it not been for the circumstance that its claim was secured by a surety's bond. If, for one reason or another, the surety had withheld payment to the Commonwealth, the latter would have continued to receive dividends on the full amount of its claim, or if, on a nice calculation, the surety had at the outset satisfied its principal's obligation, it would have been entitled to share on the basis of the full amount. On the other hand, if the surety's participation should be limited to the extent now urged by the receiver, the other creditors would profit solely because of fortuitous circumstances and without any relation to reasons of intrinsic fairness. The extent of the participation of the surety, and therefore that of the other creditors, would depend on how, when, and against whom the secured creditor presses its claim. Cf. *In re Thompson*, 300 Fed. 215, 217-18; *Pace* v. *Pace*, 95 Va. 792, 799. Such a result leaves too much to caprice or accident and is wholly at variance with the guiding criterion of "ratable" distribution.[1]

[1] Reflecting the special policy of bankruptcy legislation favoring the general creditor against the secured creditor, the rule prevails in bankruptcy that dividends upon the claims of secured creditors "shall be paid only on the unpaid balance." § 57(h), 30 Stat. 544, 560, 11 U. S. C. § 93(h); 14 Stat. 517, 526. It is settled, however, that the "bankruptcy" rule is inapplicable to the distribution of assets of insolvent national banks. Merrill v. National

A final consideration needs mention. The receiver cites several instances in which the Comptroller of the Currency has stated that the basis of a surety's claim is to be measured by the amounts it has expended. But there is wanting here any long-continued practice which establishes its own law within the permissible area of administrative action. Cf. *Inland Waterways Corp.* v. *Young*, 309 U. S. 517, 524-25.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

Bank of Jacksonville, 173 U. S. 131. There is no occasion to reexamine the correctness of that decision, the authority of which has never been questioned here and was again recognized very recently. Ticonic Bank v. Sprague, 303 U. S. 406, 412. Although the National Bank Act has been amended many times since its original enactment in 1864, 13 Stat. 114, the provision governing distribution of dividends has remained substantially intact. The construction given the provision in the Merrill case has been left unchanged by Congress.

SUPREME COURT OF THE UNITED STATES.

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 8, 1941.]

Mr. Justice Douglas, dissenting.

The only virtue possessed by *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, is the fact that it has been on the books for over forty years. It held that a secured creditor could receive dividends on the face amount of his claim even though that claim had been reduced by the value of the collateral between the date of insolvency and the date of distribution. That rule of distribution is inequitable and unfair to the run of depositors. It gives an advantage to the secured creditor unwarranted by any provision of his contract. For it treats the claim as wholly unpaid even though it has been partially discharged by liquidation of the collateral. The impact on other creditors is oppressive. Under the rule of the *Merrill* case a depositor with a $10,000 claim, secured by $5,000 worth of collateral, will be wholly paid if the insolvent bank pays a 50% dividend. On the other hand, an unsecured depositor with a $10,000 claim salvages under those circumstances only $5,000. A rule of distribution which sanctions such a discriminatory result violates the requirement for "ratable" dividends prescribed by the National Banking Act. R. S. § 5236, 12 U. S. C. § 194. This is no occasion, however, to elaborate on the point. It was fully covered in its historical and legal aspects by the dissenting opinions of Mr. Justice White and Mr. Justice Gray in the *Merrill* case.

The majority of the Court was of the view that whatever might be the power of Congress under the bankruptcy clause of the Con-

stitution, the adoption of the bankruptcy rule[1] in equity would be an invasion of "prior" contract rights (173 U. S. at p. 146)—an impairment of obligation of contract. And the reason for that conclusion was based on the theory that since "the creditor's rights in the trust fund are established when the fund is created, collections subsequently made from, or payments subsequently made on, collateral, cannot operate to change the relations between the creditor and his co-creditors in respect of their rights in the fund." (p. 140.) For that reason it was held that the claims of creditors are to be "determined as of the date of the declaration of insolvency". (p. 147.) There is serious question whether that foundation has not been swept away by *William Filene's Sons Co.* v. *Weed*, 245 U. S. 597.

Mr. Justice Holmes stated in the *Weed* case (p. 602): "But when the courts without statute take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept. In order to make a distribution possible they must of necessity limit the time for the proof of claims. But they have no authority to give to the filing of the bill the effect of the filing of a petition in bankruptcy so as to exclude any previously made and lawful claim that matures within a reasonable time before distribution can be made."

That theory runs counter to the assumption in the *Merrill* case (173 U. S. at p. 136) that a creditor acquires a "vested interest in the trust fund" antedating distribution. For if that assumption were valid, the claim in the *Weed* case, which had matured

[1] It should be noticed that the bankruptcy rule, now codified (Bankruptcy Act § 57(h), 11 U. S. C. § 93(h)), which allows the secured creditor to receive dividends only on the balance remaining after the value of the security has been deducted from the claim, did not derive from a special statutory provision. As pointed out by Mr. Justice Gray in his dissent in the *Merrill* case (173 U. S. at pp. 174-175) the Bankruptcy Act of 1841 (5 Stat. 440) had no such provision. Yet its requirement for "pro rata" distribution (§ 5) was recognized by Mr. Justice Story, its draftsman, as permitting a secured creditor to prove only for the balance of his claim as remained after crediting the value of the security. Ex parte City Bank of New Orleans, 3 How. 292, 315. That rule of construction followed the long established English bankruptcy rule. See Mr. Justice White, dissenting, 173 U. S. at pp. 153-155. As stated by Lord Eldon in Ex parte Smith, 2 Rose Bank. Rep. 63, 64, until the secured creditor's claim has been reduced by deducting the value of the security "it is impossible correctly to say what the actual Amount of it is."

after the proceedings had been instituted, would have been disallowed. Such an assumption would likewise fail to take heed of the admonition of Mr. Justice Holmes that "supposed equities other than those determined by the contracts that the debtor was content to make and the creditor to accept" are not to be recognized.

Yet, assuming *arguendo* that the premise of the *Merrill* case has survived, the answer to the proposition that application of the bankruptcy rule would result in impairment of obligation of contract was completely answered by Mr. Justice White (173 U. S. at p. 152): " . . . the preferential right arising from the contract of pledge is in nowise impaired by compelling the creditor to first exercise his preference against the security received from the debtor, and thus confine him to the specific advantage derived from his contract. Further, however, as the contract, construed in connection with the law governing it, restricts the secured as well as the unsecured creditor to a ratable dividend from the general assets, the secured creditor is prevented from enhancing the advantage obtained as a result of the contract for security, by proving his claim as if no security existed, since to allow him to so do would destroy the rule of ratable division, subject and subordinate to which the contract was made." And see Glenn, Liquidation (1935) § 530.

This analysis of the *Merrill* case is germane to the present problem not merely to focus the historical setting of the rule which we are asked to enforce. It is especially important because we are now asked to extend that rule to a special type of *unsecured* creditor.

The surety who seeks its protection has an *unsecured* claim for $68,500. It seeks to gain the advantages which a secured creditor with a claim of $135,000 would have, i. e. the right to receive dividends on that basis. To deny the surety that preference would be no invasion of "prior contract rights", no impairment of obligation of contract, under the theory of the majority in the *Merrill* case. This surety neither has nor had any claim which was secured. Nor did it have any fixed and liquidated claim at the date of the declaration of insolvency. Its claim was always unsecured and it matured, as in the *Weed* case, after the appointment of the receiver. Nevertheless, this surety, though it would fail to gain the preferred position of a secured creditor under the test of the

Merrill case, is allowed to reach that position through the back door of subrogation.

It is ordinarily true that a surety succeeds to all of the rights and remedies of the creditor including the latter's priority. *Lidderdale's Executors* v. *Executor of Robinson,* 12 Wheat. 594. But that is no inexorable rule. As this Court stated in *Memphis & Little Rock R. R. Co.* v. *Dow,* 120 U. S. 287, 301-302, "The right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice." In determining whether it would be fair or equitable to allow the subrogation to the full extent of the creditor's rights and remedies, consideration will, of course, be given to the prejudice, if any, suffered by other creditors. But the mere fact that the other creditors will not be worse off than if the surety's principal had pressed the claim is not the sole solvent of the problem. We are not dealing with a mechanical rule. The question remains whether justice requires or policy permits the surety to succeed to his principal's privileged position.

Such considerations frequently are a barrier to any subrogation; at other times they may cut down the rights of the surety and give him less than his principal could exact. Illustrations of the former are *German Bank* v. *United States,* 148 U. S. 573, where subrogation was denied because it arose from conduct which was tortious; and *United States* v. *Ryder,* 110 U. S. 729, where a surety on recognizance bail was denied subrogation to the rights of the United States. In the *Ryder* case subrogation was denied because, *inter alia,* its allowance "would be to aid the bail to get rid of their obligation, and to relieve them from the motives to exert themselves in securing the appearance of the principal. Subrogation to the latter remedies would clearly be against public policy by subverting, as far as it might prove effectual, the very object and purpose of the recognizance." *Id.,* p. 737.

Closer in point, however, are those cases which award the surety less rights than his principal had. Thus *South Philadelphia State Bank's Insolvency,* 295 Pa. 433, held that while a surety was entitled to be subrogated to the rights of a State against an insolvent bank, the surety did not in absence of statute[2] acquire the

[2] By statute a surety of the United States succeeds to the latter's priority. R. S. § 3468, 31 U. S. C. § 193. It should be noted, however, that though the United States has priority against an insolvent (R. S. § 3466, 31 U. S. C. § 191) that priority has been held not to extend to an insolvent national bank. Cook County Nat'l Bank v. United States, 107 U. S. 445.

State's priority. See Arnold, An Inequitable Preference in Favor of Surety Companies, 36 W. Va. L. Q. 278; (note) 81 U. Pa. L. Rev. 441. The theory of that case is that "the State's right to a preference over other creditors, being a sovereign right enjoyed for the benefit of all the people, cannot be transferred to individuals except by express legislative sanction." (p. 440.) Though that case represents the minority view in the state courts,[3] it is recognition of the healthy principle that application of the rule of subrogation should not be reduced to a conceptualistic formula.

The sweep of that principle is illustrated by *Memphis & Little Rock R. R. Co.* v. *Dow, supra.* In that case the prior lien creditor had a claim with interest at 8%. To allow the surety the same rate of interest would not have put the junior lienor in a worse plight. But this Court disallowed that rate, pointing out (120 U. S. at p. 302) that the surety was entitled only to reimbursement. A similar approach in this case would be to ascertain the equities of the surety's claim not by looking for the principal's rights under its contract but for reasons why this surety should be accorded priority over other unsecured creditors. Equity has regard not only for the rights of other creditors (*Jenkins* v. *National Surety Co.*, 277 U. S. 258) but also for the stake which the surety has and which it is asking a court of equity to protect. A court of equity should neither "come to the aid of one" whose equity is "subordinate until claims superior in equity" have been satisfied (*American Surety Co.* v. *Westinghouse Electric Mfg. Co.*, 296 U. S. 133, 136), nor create superior equities on behalf of one who can show no more compelling reasons for preferred treatment than can those with whom he competes. Under such an approach this surety would be denied a superior equity.

Here the surety has only an unsecured claim of $68,500. Any reason for continuation of the discrimination against the general depositors of this bank disappeared when the surety's creditor was paid. No equity has been suggested for allowing this surety preferred treatment. It was paid to assume the risk of insolvency of the bank. It was paid by the bank itself. And it has not been shown that it charged a lower rate because of the rule of the *Merrill* case. In view of those circumstances it should not be allowed the lion's share. It is entitled to reimbursement but certainly in no

[3] See Arant, Suretyship (1931), p. 363.

greater an amount than the run of depositors. It is no answer to say that such a result would give the general depositors a windfall. Unless subrogation is to be a mechanical formula, this surety should be required to establish its special equity to preferred treatment—reasons why it unlike any other unsecured creditor should enjoy the benefits of the discriminatory rule of the *Merrill* case.

Finally, it is suggested that if the surety is not allowed this preference, much will be left to "caprice or accident", since the surety would have been entitled to share on the basis of the full amount if it had satisfied the creditor's obligation at the very outset. The answer to that is that we would then have to determine whether the *Merrill* case has survived the *Weed* case (See Clark, Proof by Secured Creditors in Insolvency and Receivership Proceedings, 15 Ill. L. Rev. 171) and if so, whether it should be overruled. It is sufficient at this time to say that in view of the flimsy basis on which the *Merrill* case rests and the oppressive nature of the rule it fashioned, it should not be extended.

Mr. Justice BLACK concurs in this dissent.